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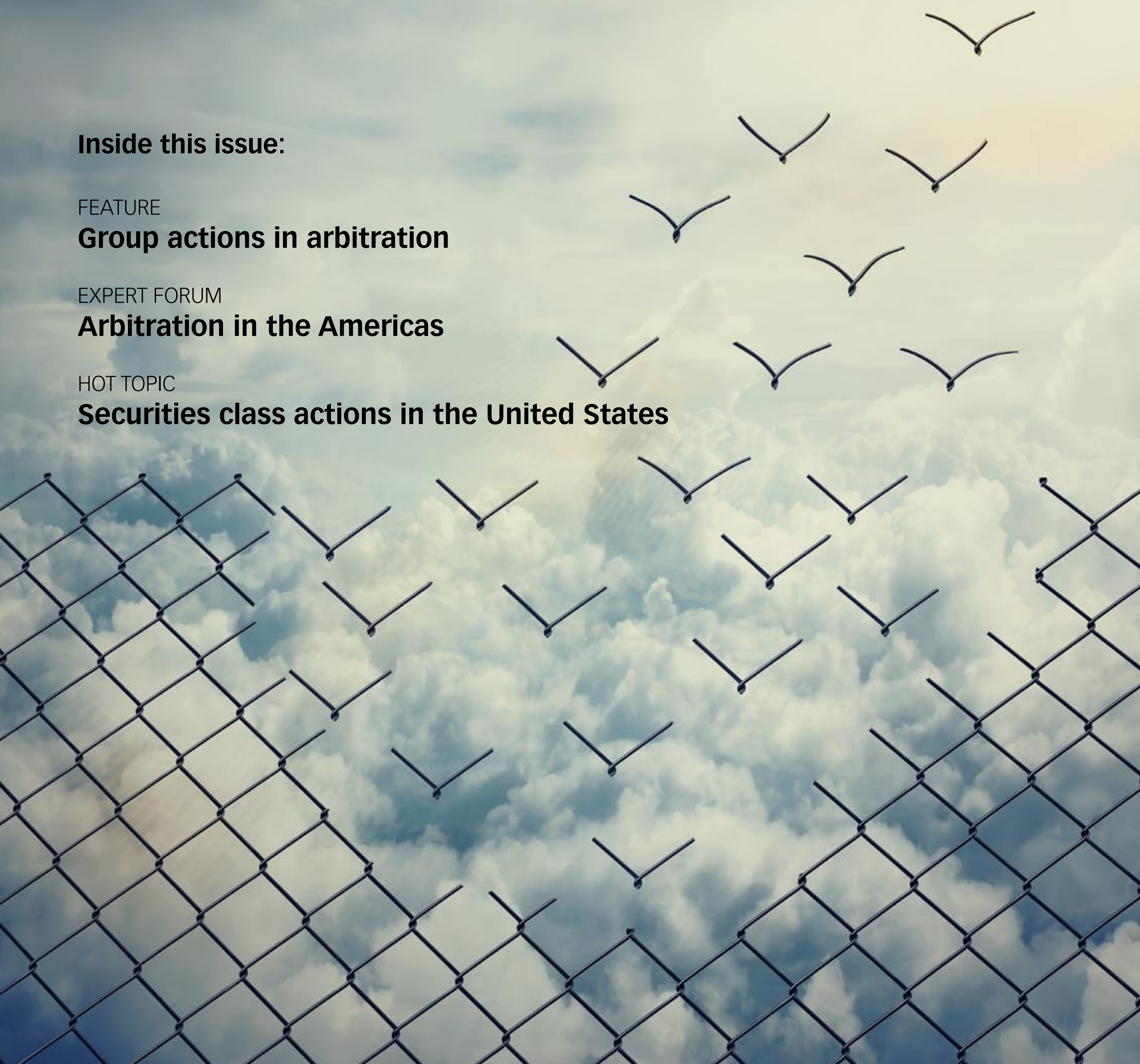

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FOREWORD

Welcome to the fourteenth issue of Corporate Disputes, an e-magazine dedicated to the latest developments in corporate and commercial disputes. Published quarterly by Financier Worldwide, Corporate Disputes draws on the experience and expertise of leading experts in the field to deliver insight on litigation, arbitration, mediation and other methods of dispute resolution.

In this issue we present features on group actions in arbitration and on financial institutions litigation. We also look at arbitration in the Americas; commercial disputes; enhancing transparency; international insurance and reinsurance arbitration; pro-arbitration decisions in Hong Kong; the new investment court system; enterprise resource planning litigation; the role of insurance in litigation; the future of litigation funding; ADR solutions for small business problems; dispute resolution in Turkey; restrictive covenants; cyber security and employee risks; attorney-client privilege; the Frade oil spill litigation; class actions coming the UK; French class action; securities class actions in Canada; securities class actions in the United States; and more.

Thanks go to our esteemed editorial partners for their valued contribution: IT Group; Kasowitz, Benson, Torres & Friedman LLP; Moroglu Arseven; Von Wobeser y Sierra, S.C.; Woodsford Litigation Funding; the American Arbitration Association (AAA); the Association for International Arbitration (AIA); CEDR; the Chartered Institute of Arbitrators (CIArb); the International Center for Compassionate Organizations (ICCO); the Center for the Study of Dispute Resolution at the University of Missouri School of Law; and the New York International Arbitration Center (NYIAC).

– Editor

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FEATURE

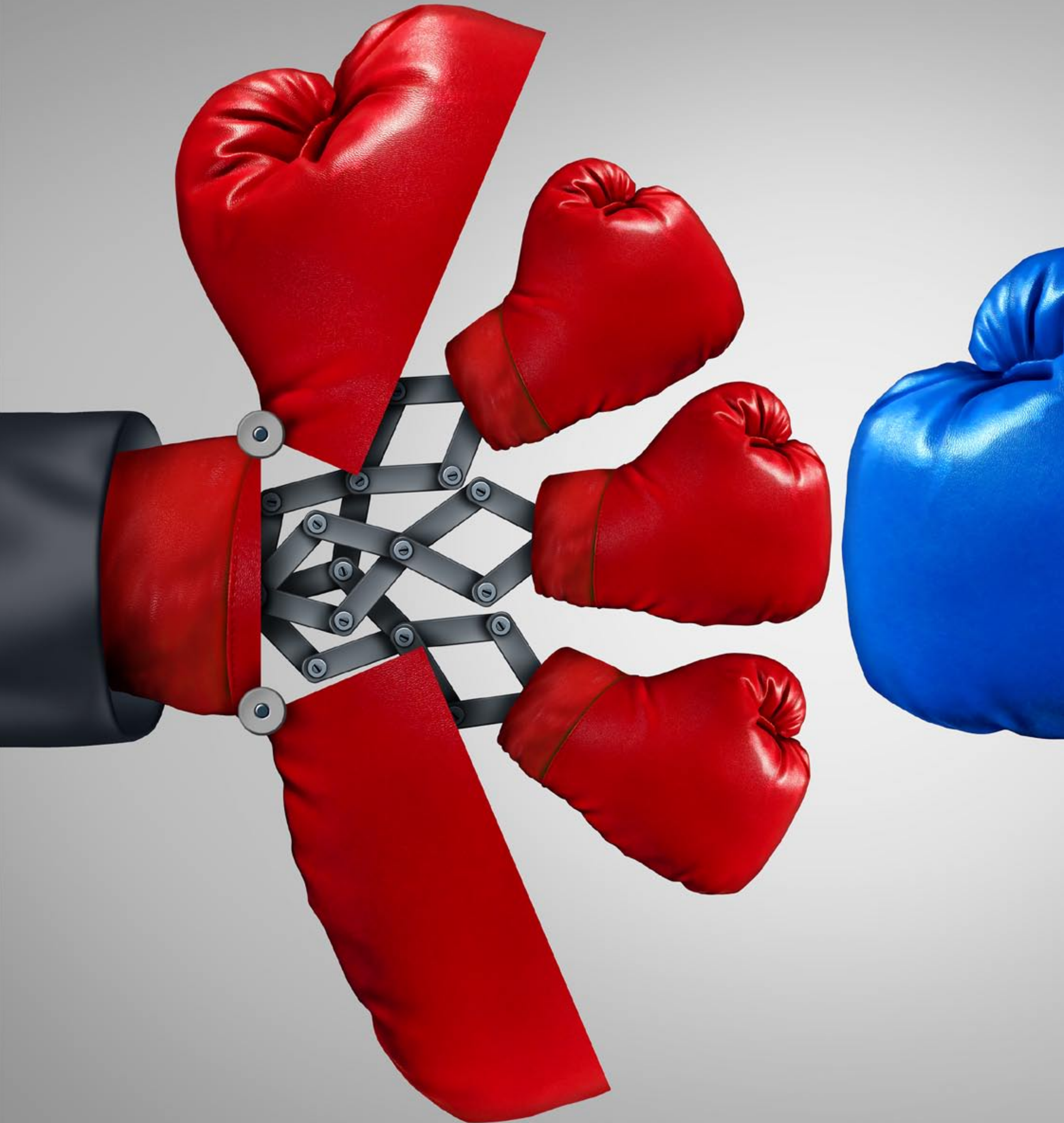
GROUP ACTIONS IN ARBITRATION

BY **RICHARD SUMMERFIELD**

Utilising arbitration as a means of resolving disputes is becoming increasingly popular, encroaching on territory previously reserved for litigation. As we have begun to see in increasing numbers, the courtroom is not always the optimal setting for resolving a legal conflict. This is increasingly evident for issues requiring collective redress.

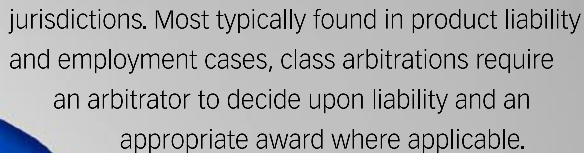
Class arbitration has been around for some time; indeed, the concept can be traced back hundreds of years to the 'Bill of Peace' in seventeenth century Britain. Though the process evolved in the UK, being replaced by representative action, it has truly flourished in the US. The American Arbitration Association (AAA) and the Judicial Arbitration and Mediation Services have both introduced rules allowing class arbitrations and, to date, the AAA has administered more than 300 class arbitrations.

A class arbitration is a alternative means of settling a dispute. A group arbitration action will see a group of plaintiffs band together to file a single complaint against an organisation. Class actions have been viewed as a particularly American procedure, but they have begun to spread to other



jurisdictions. Most typically found in product liability and employment cases, class arbitrations require an arbitrator to decide upon liability and an appropriate award where applicable.

Over the past two decades, class action procedures in the US have migrated from litigation to



arbitration in domestic practice. A number of state courts, particularly those in California, were the standard bearers for this switch. Those state courts facilitated arbitrations conducted on behalf of large numbers of similarly-situated claimants, more often than not those claimants, typically consumers.

Yet the notion of making arbitration available for class actions has been hotly debated elsewhere. Europe, for example, is a huge potential market for class arbitration, but due to differences between the EU Member States and methods of dealing with collective redress, the idea has yet to take hold in the region. "The debate around group and class actions in arbitration often centres on consent, due process and administrability," says David Cinotti, counsel at Venable LLP. "Without consent, arbitrators have no authority to decide the parties' dispute. And there is considerable debate as to whether a treaty or contractual arbitration clause that is silent or ambiguous on the topic provides for consent to arbitrate against a mass group or class of claimants. Similarly, there are due-process concerns for both members of a class in a class arbitration who are not directly participating and respondents who might be deprived of the opportunity to address individual aspects of each claim when faced with a large number of claims or absent class members. There is also a debate as to the practical administrability of such arbitrations, including with regard to identifying and documenting claims, treating differences among claimants, and apportioning damages."

Bazzle and *Abaclat*

The 2003 decision of the United States Supreme Court in the case of *Green Tree Financial Corp vs. Bazzle* and the decision of an investment arbitration tribunal in the Abaclat case to assume jurisdiction in a single arbitration over the claims of 60,000 Italian bondholders with claims against Argentina, have helped to catapult class arbitration into the legal consciousness.

In the *Abaclat* case, in 2011, a divided tribunal found that it had jurisdiction to deal with a mass claim brought by 60,000 Italian bondholders in relation to a sovereign debt default by Argentina in 2001 during its financial crisis. The decision in *Bazzle* in particular is credited with popularising group arbitrations in the US. "It is difficult to say generally whether group or class arbitration works in practice. The Argentine cases will provide some good examples in the investor-state context. In the commercial context, at least under US arbitration law, it is more difficult to know given the US case law limiting the ability of claimants to bring class arbitrations and the fact that commercial procedural orders and awards are less often published than in investment-treaty cases. I think it can work in the right case, but that there are some serious concerns relating to due process and practical administration," says Mr Cinotti.

Class arbitration has indeed been a transformative process for dispute resolution in the US. In *Stolt-Nielsen S.A. vs. AnimalFeeds International Corp*, the Supreme Court stated that class arbitration "changes the nature of arbitration". The Supreme Court's subsequent decision in *AT&T Mobility LLC vs. Concepcion* also reflected this opinion. "Class arbitration has become a focus in the United States, primarily in the consumer context, as companies included class-action waivers in their contracts, prompting claimants to seek to bring class arbitration," says Mr Cinotti " In response, companies have also sought to preclude class arbitration and to argue that class arbitration is not permitted under their arbitration clauses. In the investor-state context, mass arbitration responds to the high cost of investor-state arbitration and the large-scale impact of some sovereign acts, such as Argentina's restructuring of its bonds. In the US, I expect companies to continue to take steps to preclude class arbitration, and for US courts to enforce those limits. Given the decisions in *Abaclat* and other cases, however, I expect more attempted mass investor-state claims, although it will require specific sovereign acts that have widespread and substantially similar impact on investors, and tribunals might reach different decisions based

"Given that the arbitration process exists outside the national court system, it can be an attractive option. Its comparative cost effectiveness compared to litigation can be a further fillip."

on different treaty language and the arbitrators' individual views. States might also limit or eliminate class or mass arbitration in future bilateral investment treaties," he adds.

The Supreme Court has waded into the question of group arbitration with decisions in two recent cases. In *Oxford Health Plans LLC vs. Sutter* and *American Express Co vs. Italian Colors Restaurant*, the Court clarified its position on class arbitration. The two decisions established that there must be some "contractual basis" for concluding contracting parties "agreed to authorise" class arbitration to justify the imposition of such proceedings. In these decisions, the Court explained that, firstly, an intent to permit class arbitration may not be inferred simply by virtue of the parties' agreement to arbitrate their disputes, and secondly, if parties vest authority in the arbitrator to determine the availability of class proceedings under their clause, as long as the arbitrator is "even arguably" construing the clause, this ruling will be upheld under the FAA's highly deferential standard of review.

While states and the Court may attempt to limit or do away with class arbitrations as much as possible, companies often attempt to undermine the process. Historically, class arbitrations have been unpopular among companies, given a general perception that they impact on the cost and complexity of legal action brought against them. Accordingly, companies attempt to avoid class arbitrations by choosing to settle a dispute in a location which does not provide for class arbitration, or by inserting a waiver clause in arbitration agreements which forbids the use of a class arbitration.

Given that the arbitration process exists outside the national court system, it can be an attractive option. Its comparative cost effectiveness compared to litigation can be a further fillip. Arbitration offers companies a neutral forum for dispute resolution around international transactions and an opportunity to address large scale claims through a single mechanism and without a jury. From the perspective of the claimants, class arbitration offers the ability to seek satisfaction of claims that may be too expensive to pursue individually, as well as awards that are potentially enforceable in a broad range of jurisdictions. Arbitration clauses are being included as a dispute resolution mechanism of choice in a wide variety of consumer products contracts.

In October 2015, the Consumer Financial Protection Bureau (CFPB) announced two proposals related to the inclusion of clauses that require arbitration to resolve all future disputes ('pre-dispute arbitration agreements') over consumer financial products. The first proposal effectively bans pre-dispute arbitration agreements that prohibit disputes brought by a class or other group of individuals. Under the proposal, all pre-dispute arbitration agreements would be required to "provide explicitly that the arbitration agreement is inapplicable to cases filed in court on behalf of a class unless and until class certification is denied or the class claims

are dismissed". The CFPBs proposals would follow in the footsteps of brokerages; under rules set forth by Wall Street's self-regulator, the Financial Industry Regulatory Authority, brokerages aren't allowed to include such waivers in their customer agreements.

The purpose of this proposal is to address findings in the CFPB's March 2015 report, which was produced following a three-year study into the use of arbitration agreements in consumer financial products. The CFPB found in contracts for bank accounts, credit cards or other financial products that both require the resolution of all disputes in arbitration proceedings and prohibit consumers from conducting an arbitration proceeding as a group or class.

According to the CFPB, these sorts of clauses protect organisations from class litigation and essentially prevent consumers from obtaining remedies for alleged harms that may be considered too small or insignificant to pursue on an individual basis. The Bureau did consider allowing businesses to continue using arbitration clauses which require all disputes to be resolved via arbitration, provided that those clauses allowed for group arbitration proceedings. However, as class arbitration rules have not been widely applied to consumer finance disputes, the CFPB "is not confident that class arbitration is a reliable setting for aggregated resolution of consumer finance claims". As such, the CFPB's proposals will not prohibit arbitration clauses that permit a consumer to choose either arbitration or litigation to resolve a group or class dispute, as long as the clause does not require the consumer to participate in class arbitration rather than a class action lawsuit.

The second proposal would require companies to submit to the CFPB for further review all claims filed and written awards produced in arbitration proceedings, provided that the company included a pre-dispute arbitration agreement in a consumer financial product.

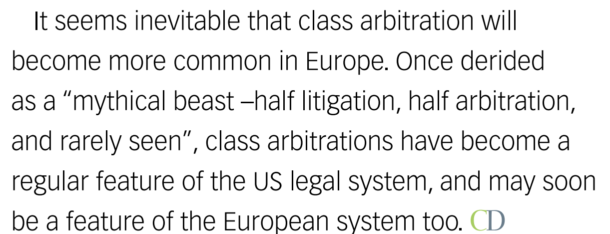
European perspectives

Group arbitrations have evolved as a primarily US focused phenomenon, however they are being considered in other jurisdictions. Europe, for example, is fertile ground. The size of the region, the free movement of people across the continent and the cross-border nature of many businesses means there is a market of close to half a billion customers available to businesses. With consumers in the UK, Italy and Poland all able to buy the same products, it would be prudent for there to be an efficient and practical method of resolving mass claims. Yet to date, the lack of cohesion seen across Europe as it pertains to collective redress is an issue. As Mr Cinotti notes, "European systems, generally speaking, have less experience with group or class actions than the United States." Many European lawyers approach class arbitration with considerable trepidation. While opinions surrounding class actions

in the US have moved on, very little progress has been made on the other side of the Atlantic.

To date European efforts to introduce class arbitrations have hinged upon the premise that any European system of collective redress should be based on an 'opt-in'. In the US, however, the class arbitration model requires an 'opt-out'. The majority of commentators believe that it is against European principles of individualised justice to allow 'opt-out' procedures.

Class arbitrations are complex and challenging cases which require considerable debate and consideration. It is imperative that courts and arbitrators take into account the principles of arbitration so that class procedures can be developed in ways that are consistent with an established arbitral framework.



It seems inevitable that class arbitration will become more common in Europe. Once derided as a "mythical beast –half litigation, half arbitration, and rarely seen", class arbitrations have become a regular feature of the US legal system, and may soon be a feature of the European system too. CD

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FEATURE

FINANCIAL INSTITUTIONS LITIGATION AND THE UK'S EVOLVING REGULATORY LANDSCAPE

BY **FRASER TENNANT**

Largely attributable to the havoc wrought on the financial sector by the LIBOR and Forex (FX) market manipulation scandals, among others the UK regulatory landscape has now become a much more stringent animal which, in turn, has had a significant impact on the litigation practices and strategies being deployed by financial institutions, and those who represent them.

Litigation, of course, is an expensive arena for financial institutions to enter. According to data compiled by the CCP Research Foundation, since 2010, litigation costs for the world's 16 largest banks have amounted to a mammoth £205.6bn of fines, settlements and provisions – a figure which is likely to do nothing but increase exponentially.

Over the past few months, UK Courts have overseen a number of market manipulation accusation cases, including 10 former bankers from Barclays and Deutsche Bank charged by the Serious Fraud Office (SFO) with conspiracy to defraud in connection with the Euribor interest rate benchmark, and six brokers that allegedly conspired to assist ex-bank trader Tom Hayes in his manipulation of the LIBOR interest rate benchmark.

Reflecting on a sector in dire need of reform, in November 2015, Bank of England governor Mark Carney told a meeting of policymakers, academics and senior bankers in central London that the "age of irresponsibility" in the City was now at an end and that financial services reforms, as well as tighter

financial market regulation, were essential if the UK was to continue as a leading international financial sector.

Much of the massive recompense now being extracted from institutions found guilty of financial skullduggery is as a result of a far more aggressive and punitive regulatory backdrop – an evolution most visibly exemplified by the new competition powers and enforcement priorities afforded to the Financial Conduct Authority (FCA) and the SFO.

Such powers – which in the case of the FCA include the regulation of financial benchmarks specified by HM Treasury such as SONIA, RONIA, ISDAFIX, WM/Reuters London 4pm Closing Spot Rate, London Gold Fixing, LMBA Silver Price, ICE Brent Index, and the afore-mentioned LIBOR and FX – give regulators extensive scope to fundamentally influence how financial institutions formulate their future culture and conduct – both in terms of their attitudes toward litigation and in their general disposition.

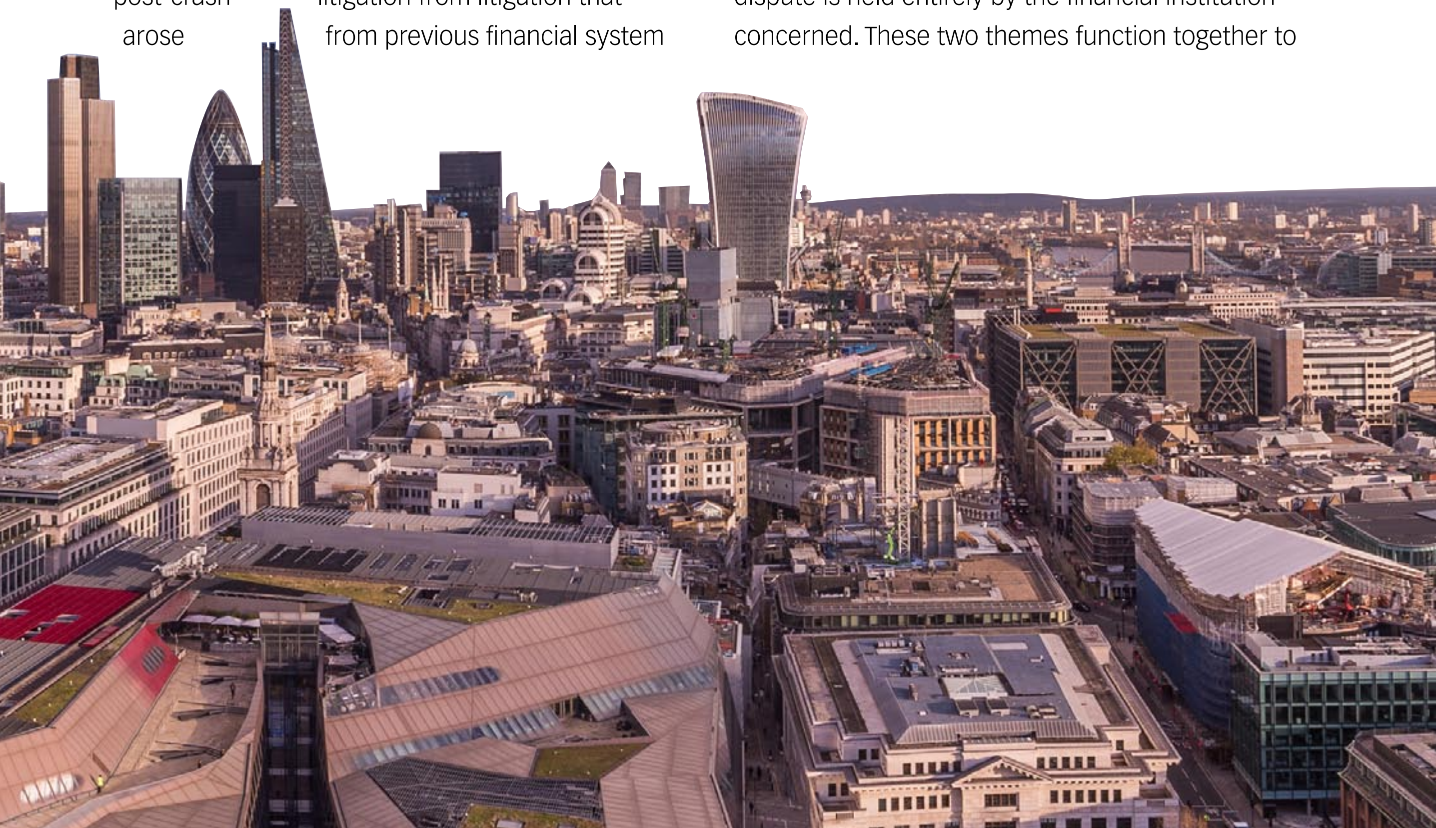
With a stream of high-profile cases currently winding their way through the UK's legal system, financial institutions litigation is in the spotlight like never before, subject as it is to ongoing probes and investigations by national and global regulators. Moreover, the fact that financial institutions are being investigated raises the very real possibility of copycat litigation across multiple territories.

Rapidly evolving and encompassing myriad legal and business challenges, the UK's financial institutions landscape is all set to have a major impact on litigation settlements in Europe and across the globe.

Cause and effect

The current financial institutions litigation landscape is an environment largely shaped by the impact of the 2008 credit crunch, asserts Robert Worthington, a senior legal project manager at Herbert Smith Freehills LLP. Within this are two defining themes that differentiate the current post-crash litigation from litigation that arose from previous financial system crashes. "The first theme is the regulatory overlay," says Mr Worthington. "If we look at the main areas of dispute – shareholder litigation, FX and LIBOR – the regulatory sanctions have largely been delivered and in some cases there have been findings of fraudulent conduct by individuals within such institutions. Even where no findings of dishonesty have been made, there are often significant adverse findings made against institutions. As a result of this, litigation is being conducted against a background of deep suspicion of the activities of banks and bankers."

The second theme is information asymmetry – meaning the information most relevant to the dispute is held entirely by the financial institution concerned. These two themes function together to



create a demanding environment in the conduct of litigation by solicitors advising the financial institutions. And, in light of the deep suspicion surrounding banks and bankers, conscious efforts are being made to ensure that all relevant material is being disclosed to ensure that the institution cannot be criticised for hiding material. "This, however, creates an environment where the burden of disclosure and witness statements falls largely to one party, and that presents significant challenges in ensuring the pre-trial process is run fairly and efficiently," concludes Mr Worthington.

For Jo Rickards, a partner at Kingsley Napley LLP, another major challenge is the increasingly global nature of investigations, involving a raft of litigators and regulators representing multiple jurisdictions. "This makes it very complex and expensive for even the largest banks and multinationals," she suggests. "And individuals under scrutiny are in an ever more vulnerable and untenable position. There are no hard and fast rules for identifying which jurisdiction should take the lead as we are increasingly seeing a divergent approach to priorities. While tackling corporate liability has been a recent focus in the UK, the Yates Memo in the US, a DOJ policy announced in September 2015 which focuses on individual accountability for corporate wrongdoing, puts the individual back at the centre. You have got to cough up the individuals."

Litigation strategies

Under the spotlight like never before, financial institutions have been forced to change their ways and rapidly formulate new litigation strategies to cope with ongoing market manipulation court cases – litigation that requires financial institutions to be transparent to a much greater degree.

"The downside to heightened disclosure is that the provision of information is now less tightly defined. This, in turn, significantly increases the costs of litigating."

"Financial institutions now approach litigation on an 'all cards on the table' basis and will be more willing to provide wider disclosure to avoid being criticised for hiding documents," says Mr Worthington. "This flows on to the wider provision of other information, such as meeting Request for Information inquiries and other applications for information. There is a greater unwillingness to

challenge for relevance as financial institutions want to demonstrate that they have nothing to hide."

Yet the downside to heightened disclosure is that the provision of information is now less tightly defined. This, in turn, significantly increases the costs of litigating. It also impacts the range of tactical strategies that can be implemented, especially at an early stage, to ensure that the litigation proceeds on a narrower, more focussed platform.

In addition to the reputational harm financial services have suffered through regulatory action, financial services firms are, in general, unwilling or unable to proceed with challenges against insufficient pleadings until sometime after the exchange of witness statements. This means that proceedings can be started on a very wide footing and proceed on this basis for a considerable time, until the claimants are forced to properly plead after the exchange of witness statements. "In short, financial institutions are less willing now to take assertive points to try to narrow down issues and reduce the scope of relevance, because they need to appear to be helpful and without anything to hide, and the courts view on information asymmetry means that such challenges are unlikely to succeed," says Mr Worthington.

Further regulatory reforms

The aggressive regulatory stance adopted by the SFO and FCA, which has clearly borne fruit, has led to calls for further reform including greater competition powers. Answering these is the FCA's new 'Senior Managers and Certification Regime', due to be implemented on 7 March 2016 – new conduct rules which Martin Wheatley, FCA chief executive, described as "adding further momentum to improving standards across the industry."

The FCA's overture, formulated alongside the Prudential Regulation Authority (PRA), aims to improve individual accountability in the banking sector by holding individuals working at all levels in banking to appropriate standards of conduct. And yet, while this drive to ensure accountability has become something of a regulatory mantra, according to Ms Rickards, the reforms currently in the July 2015 Bank of England Bill do not accurately reflect the hard-line stance taken to date and in actuality represent something of a U-turn from a presumption of responsibility to a duty of responsibility.

"The SFO backed the UK government's plan for a new offence of a corporate failure to prevent economic crime and extend the rules on establishing corporate criminal liability more widely," says Ms Rickard. "Vicarious liability was mooted as an option and is still something the SFO would welcome. However, as this was quietly taken off the table, we appear to be witnessing a gap between political rhetoric and legislative reality."

Trends and developments

With financial market manipulation allegations and court cases all set to continue as we progress

further into 2016, the financial institutions litigation arena is in flux as parties reassess their changing roles and responsibilities. To be sure, major challenges lie in wait as a host of dispute management trends and developments take root. Celina McGregor, a senior associate at Herbert Smith Freehills, considers data governance to be one such major challenge for those at the sharp end of financial institutions litigation. "Storing data is relatively cheap, keeping it in a meaningful and secure way is not," she explains. "Added to this the 'kitchen sink' approach some take to their claims and the dynamics mean that the costs of disclosure soon grow out of proportion to the sums at stake. There is clearly an argument for a stricter approach to pleadings and more limited disclosure orders. In the meantime, the exponential growth of alternative legal services platforms supported by more sophisticated technology – such as machine learning for document review – will be integral to the future of the market," she adds.

Going forward, the demand for cooperation is likely to remain centre stage, with internal investigations and interplay with authorities being key factors. "The FCA and SFO have underlined their expectation of early and effective engagement," says Ms Rickards. "How an internal investigation is to be framed, and whether the content is to be subject to privilege are all issues in the SFO's sights. The issue of limited waiver of privilege is complicated where you have other jurisdictions that do not recognise that as a concept and where there could be follow-on civil litigation."

Conclusion

Evolution in the UK finance sector is underway. The numerous competition and market manipulation cases seen in recent years have resulted in a more challenging regulatory landscape and made financial institutions litigation an area that is rapidly escalating in importance. In a nutshell, market manipulation claims abounded, regulators responded, convictions resulted and with financial institutions remaining very much under the spotlight, it could well be the case that the worst of the litigation is yet to materialise. CD

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Marco Tulio Venegas is a partner at Von Wobeser y Sierra SC. Mr Venegas's practice areas are administrative, antitrust and intellectual property litigation, civil and commercial litigation; constitutional (Amparo) litigation; tax litigation and advising; international commercial arbitration; and advising in the execution of all kinds of commercial contracts and transactions and in governmental contracts and procurement.

CD: Could you provide a general insight into the evolution of arbitration across the Americas? Is there a growing appetite to resolve disputes through arbitration?

Martinez: It is difficult to generalise as to the evolution of arbitration throughout the Americas, as there are many countries that have had vastly different experiences regarding the development of arbitration and other alternative dispute resolution (ADR) methods within their borders. Moreover, there have been differences regarding the development of their arbitration cultures as it relates to commercial arbitration and investment arbitration, where we have seen varying levels of acceptance and rejection from country to country. I do believe that in the Americas there is a broader acceptance of international commercial arbitration that continues to grow and gain in popularity as a mechanism to resolve cross-border disputes.

Dosman: Resolving commercial disputes by arbitration is becoming increasingly popular in the Americas. Parties are drawn to the neutrality of the forum, the potential to choose the decision-makers, and the increased confidentiality afforded by arbitration proceedings. The growth was recognised by the International Court of Arbitration of the International Chamber of Commerce (ICC), which in 2013 established a full branch of the ICC Secretariat in New York (SICANA). The statistics on case filings to date have also borne out the growing attraction of international arbitration as a dispute resolution mechanism. In 2014, the number of US parties in ICC arbitration increased by 28 percent over the previous year. And the International Centre for Dispute Resolution (ICDR) – the international arm of the American Arbitration Association – reported over 1000 new cases filed last year. In the Southern hemisphere, demand for arbitration services continues to increase, with the ICC reportedly planning to open a branch in São Paulo, Brazil.

Yanos: Arbitration will continue to grow as a form of dispute resolution in the Americas. There are three primary drivers to the inclusion of arbitration clauses in international agreements – that is, agreements covering more than two jurisdictions. First, the desire to avoid any discrimination in the home courts of the other party to the agreement. Second, the desire to maintain the confidentiality of the legal arrangements underlying the contract. Third, the desire to appoint specialised arbitrators to resolve the dispute in question – that is, arbitrators with a legal or technical expertise that will ensure that the award is consistent with the trade usages applicable in the relevant industry or consistent with the legal regime chosen by the parties to govern their agreement. On the latter point, only in an arbitration can the parties agree to resolve a dispute in New York that is governed by Peruvian law and decided by

jurists that are trained in Peruvian law. As investment in the Americas, particularly from Asia, increases, the choice of arbitration clauses to govern the parties' agreement becomes greater.

Venegas: To make a proper assessment of the evolution of arbitration in the region, we must divide between the US and Canada on one side and the Latin American countries on the other. Historically, the US and Canada have been keener to arbitrate disputes, not only related to commercial contracts, but also to several other relationships, such as consumer disputes. In this context, national arbitration is in widespread use in both countries. In connection with international arbitration, although accepted and commonly used, the culture of arbitration developing in the US and Canada could not yet be compared to the arbitration culture in Europe. In Latin America the growth and acceptance of arbitration has been slow but steady. Arbitration existed in several civil procedural codes of Latin American countries, but was not used, or its use was very limited, due to the state controlled nature of their internal markets. The opening up of Latin America's markets and the advent of free trade in the 1990s, however, gave rise to the incorporation of the UNCITRAL Model law in some countries or, in the alternative to new Arbitration Acts which incorporated the newest worldwide trends in arbitration. The impact of these developments has been an increase in the use of national and international arbitrations in old and young practitioners across the region. The number and quality of arbitrators and counsel in countries such as Argentina, Brazil, Colombia, Chile, Ecuador and Colombia has increased exponentially recently and has been successfully tested in disputes with more seasoned US and European attorneys. In fact, it could be argued that because of the growth potential in the region, the future of arbitration in Latin America looks brighter than in the US or Canada.

"The number and quality of arbitrators and counsel in countries such as Argentina, Brazil, Colombia, Chile, Ecuador and Colombia has increased exponentially recently."

Marco Tulio Venegas,
Von Wobeser

CD: What key trends have shaped arbitration rules and processes, as well as the infrastructure to support them, in the Americas?

Yanos: Over the last 20 years, there has been a general trend in the Americas to modernise the legal regimes applicable to arbitration. Brazil adopted a variant of the UNCITRAL Model law and ratified the New York Convention. Chile, Colombia and Peru also adopted variants of the UNCITRAL Model law. Unfortunately, Argentina has not sufficiently reformed its arbitration legislation and states like Venezuela have seen a deterioration of their legal system over the past decade that makes it dangerous to agree to arbitrate with Venezuelan counterparties in Venezuela. A second important trend is the development of a highly experienced and specialised arbitration bar in numerous jurisdictions throughout the Americas. Whereas 20 years ago it would have been uncommon to encounter litigators in the Americas who specialised in international commercial arbitration and dedicated more than 65 percent of their time to such matters, today there are numerous such lawyers in Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Venezuela and, of course, the US.

Venegas: One of the key trends to emerge is that arbitration practitioners have responded to the challenge of having a mixed education – both common law and civil law. Arbitration in the Americas has evolved to incorporate practice and institutions of both, civil and common law. Civil law attorneys not used to the oral cross-examination have developed the necessary skills to be able to put it in practice. On the other hand, common law attorneys have to adapt to the more legal-oriented argumentation of civil law litigation. With regard to the infrastructure, in Spanish speaking countries, several service providers – which were non-existent previously – have appeared. Transcription services for hearings, collection evidence services, consulting experts in several market areas, and so on, have been developed and are now ready to contribute to arbitrations in Latin America.

"The Americas are well-served by the legal framework for international arbitration, which includes not only the New York Convention, but also the Panama Convention."

E. Alexandra Dosman,
New York International Arbitration Center

Martinez: We have seen the passage of modern arbitration laws in many countries from the Americas. The number of professionals in the field now specialising in international arbitration has grown, along with an increasing number of law firms that

have created arbitration practice teams. In addition, some countries have developed infrastructures of good local arbitration centres with professional staff and arbitrators, well-established arbitration rules and processes, and awards that are enforced. The role of the judiciary is equally important in supporting the arbitration framework and applying the accepted trends and standards in compliance with the New York and Panama Conventions. For example, the Brazilian Arbitration Act establishes that foreign arbitration awards in Brazil shall only be subject to the confirmation proceeding before the Superior Court of Justice (STJ). This has had a positive effect in terms of the consistency of the arbitral decisions rendered by the STJ.

Dosman: The Americas are well-served by the legal framework for international arbitration, which includes not only the New York Convention, but also the Panama Convention. National laws then govern the *lex arbitri* in each jurisdiction. Within this legal infrastructure, the arbitration rules of each administering institution can adapt to incorporate innovations and changes in best practices. For example, one major trend in the last decade has been the inclusion of default emergency arbitrator provisions in many leading institutional rules, including the ICDR in 2006 and the ICC in 2012. This means that parties can now request that an emergency arbitrator be appointed prior to the constitution of the regular tribunal and can seek interim relief within the arbitral process itself. Another move has been toward increased transparency. This trend is most pronounced in the investor-state arbitration context, with the opening for signature of the Mauritius Convention in early 2015. But it is also apparent in the commercial arbitration field, with the ICC recently announcing that it would, in certain circumstances, release to the parties written decisions by the ICC Court on challenges to arbitrator appointments.

CD: How would you describe the sophistication and efficiency of arbitration centres in the region? How does this compare to leading arbitration centres in other parts of the world? Is there a need for ongoing improvement?

Venegas: There are several types of arbitration centres. Several local chambers or institutions have created their own arbitration rules, targeting either specific practices – such as construction – or more general markets. However, this proliferation in arbitration centres has resulted, in some cases, in poorly managed arbitrations. In any event, this phenomenon should lead to the 'survival of the fittest', leaving only the best quality arbitration institutions alive. Despite the above, there are some reputable arbitration centres in the region which compare favourably with more international oriented centres, such as the ICC and LCIA. In fact, some of

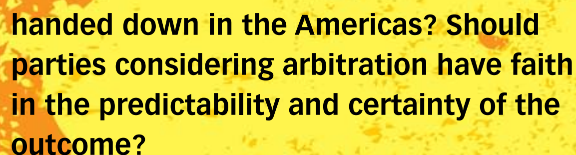
these centres have agreements with international arbitration centres which give them a more stable set of rules and experience – in exchange they help to develop local markets.

Dosman: Arbitration centres in the Americas are not only sophisticated and efficient, but also highly adaptive to the evolving needs of users of arbitration. In 2013, the New York International Arbitration Centre was opened to provide a dedicated hearing facility for international cases, along the lines of Maxwell Chambers in Singapore. New arbitration centres are appearing to serve users across the US, such as the launch of the Atlanta Centre for International Arbitration and Mediation in 2015. In terms of administration of arbitrations, users have a multiplicity of options, from relatively 'light' administration to more thorough involvement by arbitral institutions. Parties are also free to define the limits disclosure obligations – such as by adopting the IBA Rules on the Taking of Evidence in International Arbitration – thereby reducing time and cost. Parties may also choose to allow the arbitral tribunal to shift the costs of the arbitration to the losing party. Overall, the system in the Americas respects parties' choices on the procedure and conduct of the arbitration, including in areas where domestic practice differs from international norms.

Martinez: There are some good centres in the Americas, such as the ICDR, the international division of the American Arbitration Association (AAA), which operates throughout the Americas as well as globally. The ICDR works with a number of prominent centres in the Americas and has cooperative agreements with several, for example the Arbitration Centre of the Chamber of Commerce of Bogota and the Arbitration Centre of the Brazil-Canada Chamber of Commerce are two institutions that cooperate with the ICDR in the region. Yet there are many centres throughout the Americas that, although purporting to be impartial and independent with the infrastructure and capabilities to administer international arbitrations, are not. There have been numerous examples of problems encountered with centres that simply are not able to administer these types of cross-border cases. Because they may not have the essential experienced staff, rules, or infrastructure, the parties' wishes to resolve their disputes through arbitration can be frustrated.

Yanos: The arbitration centres in New York, Miami, Houston and Washington DC are commensurate with the best arbitration centres anywhere in the world. Bogota, Lima, Mexico City and Santiago also have state of the art arbitration centres and applicable rules. Hopefully, we will soon see similar changes in Buenos Aires, Caracas, Sao Paolo and the other major capitals in the Americas.

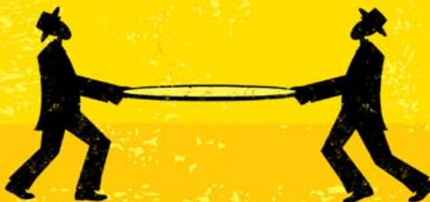
CD: Is there a strong track record of supporting arbitral decisions and awards



handed down in the Americas? Should parties considering arbitration have faith in the predictability and certainty of the outcome?

Dosman: Most arbitral awards are complied with voluntarily, but when court intervention is required a supportive judicial system is crucial. In New York, we have started a project of collecting and making public all international arbitration related court decisions. To date in 2015, these decisions reflect consistent support for the arbitral process at the two key stages of contact with municipal courts – firstly, enforcing valid agreements to arbitrate, and secondly, enforcing arbitral awards rendered both domestically and abroad. US courts recognise the deference due to international arbitral tribunals and the awards they render. The fact that a federal statute – the Federal Arbitration Act – governs almost all international arbitrations in the US provides additional comfort to parties from abroad.

Yanos: In the US, there is a strong track record supporting the recognition and enforcement of international arbitration agreements and awards. However, many courts in the US continue to require parties seeking to enforce arbitral awards to prove that the court has jurisdiction over the award debtor. In addition, many courts have applied the *forum non conveniens* defence in connection with the enforcement of foreign arbitral awards. Both practices have been criticised by proponents of international arbitration as inconsistent with the obligations of the US under the New York Convention. In Latin America, there have been some disturbing cases in Argentina and Brazil where local courts have interfered with arbitrations involving state parties. However, these cases have generally proven to be the exception, not the rule. That said, it is advisable,



if one is arbitrating against a state owned entity in Latin America, that the parties select a neutral site for the arbitration to take place – so as to avoid any temptation on the part of the courts in the jurisdiction of the state owned entity to interfere with the arbitration.

Venegas: An important trend in the region is that with the exception of arbitrations involving state-owned companies, the courts have been oriented to facilitate the enforcement of arbitral awards. In the arbitration against state-owned companies, there is a tension between arbitration enforceability and public policy. However, there have been encouraging signs that state courts are raising the bar and dismissing these kinds of public policy objections, unless it is proven to cause real – not simply economic – damage to the constitutional principles of a country. In this context, we can safely say that there is a positive degree of predictability not only on the quality of the award but also on its enforceability before local courts.

Martinez: These issues depend upon the institution that is selected by the parties in their arbitration agreement. The ICDR has a strong track record for enforced awards throughout the Americas, including awards enforced in Brazil, Chile, Colombia, Peru, as well as in the United States and globally. Predictability can be enhanced by the careful drafting of the arbitration agreement. A starting point is the institution's model arbitration clause. The ICDR's model clause can be found in its international arbitration rules and further fine-tuning suggestions can be found in online tools that assist the user in drafting the arbitration clause by highlighting a number of issues that should be considered. Predictability also is strengthened by the institutional role in providing consistent administrative procedures and by interpreting its rules and applying its policies. One example of the latter is the way the ICDR handles challenges and disclosures to help ensure that the arbitrators are impartial and independent. The ICDR's policy that requires full disclosure so that the parties' are given the choice to accept or reject the disclosure is well established and

"In the US, the most significant challenge comes from the rising tide of opposition – legal and legislative – to the arbitration of consumer products and employment disputes."

Alexander Yanos,
Hughes Hubbard & Reed LLP

provides the user with a clear understanding on how these potential conflict issues will be resolved.

CD: What do you believe are the major challenges associated with arbitration processes in the Americas?

Martinez: It is difficult to generalise, but surely one of the continuing challenges will be how the region reacts to investment arbitration in the years ahead. A number of countries are including specific arbitration agreements in their contracts for foreign investments as opposed to just having the arbitration provisions of their BITS or the Washington Convention apply. Time and costs are a continuing challenge; in response, for example, the ICDR last year promulgated its expedited procedures for international arbitration that have greatly accelerated the arbitration process and consequently lowered the costs.

Yanos: In the US, the most significant challenge comes from the rising tide of opposition – legal and legislative – to the arbitration of consumer products and employment disputes. This opposition is not, in and of itself, problematic for the arbitration of commercial disputes, but there is a risk that decisions in the consumer products or employment context could be imported into the commercial arbitration context. Furthermore, the public sentiment against arbitration in the consumer products and employment context could inadvertently spill into the commercial realm, leading to legislation that undermines the arbitration support structure currently in place. In Latin America, the two biggest challenges associated with the arbitral process are, firstly, the market's perception that Latin American states and Latin American state-owned entities will not comply with adverse arbitral awards and local courts will interfere with arbitrations involving state-owned entities or refuse to enforce adverse awards against host states or state-owned entities, and secondly, the spectre that many deals cannot be agreed in Latin America without corrupt payments.

Dosman: The expansion of international arbitration means that new entrants are using the system. This is terrific for the field overall, but may present a challenge for counsel who are not yet familiar with international norms and best practices. There has also been a great deal of debate about the ethical rules that apply to counsel engaged in international arbitration. The International Bar Association (IBA) recently issued Guidelines on Party Representation in International Arbitration. The Guidelines are a useful resource, but fundamental questions remain regarding the applicable ethical standards and the powers of an arbitral tribunal to regulate counsel conduct. Finally, complex issues can arise when disputes involve more than two parties – when can additional parties be joined to an arbitration agreement? Against whom can an arbitral award be

enforced? The issues of joinder and consolidation will only grow in importance as arbitration is adopted as a dispute resolution mechanism in larger and more complex commercial relationships.

Venegas: The biggest challenge is to extend arbitration in more commercial relationships, and to expedite the enforcement proceedings. In addition, there is a need for more qualified arbitrators in upcoming markets, such as energy and infrastructure disputes. Educating younger attorneys outside of the capitals of Latin American countries of the advantages and benefits of arbitration is also a challenge. It is an undisputed fact that the centralism existing in said countries has limited the growth of arbitration outside of capital cities, leaving the rest of the country with a slow development for national arbitrations.

CD: What recommendations would you put forward to improve the efficiency of the process and help the parties involved to manage associated costs?

Yanos: The arbitral system needs to be restructured so as to ensure that all stakeholders – tribunal, counsel and parties – have an interest in the prompt resolution of disputes. Unfortunately, it is difficult to put pressure on counsel to act more quickly because of their ethical obligation to zealously represent their clients. Thus, the most logical place to place pressure and create incentives for an increase in the speed and efficiency of the arbitral process would be to withhold payment to the arbitrators in all arbitrations until the award is rendered. This would not only encourage arbitrators to deliberate more quickly but it would also discourage them from agreeing to open-ended discovery periods and over long briefing periods. The arbitration rules could also be amended to provide shorter periods for the briefing and resolution of motions ancillary to the arbitral process such as challenges to arbitrators. Such challenges often take months to brief and months more to be decided. In point of fact, they could be briefed in weeks and decided in days. The greater delay such motions create, the more incentive some parties will have for making such motions – in some cases spuriously.

Venegas: The best recommendation would be to be very careful in the appointment of the members of the arbitral tribunal. An experienced arbitration tribunal is very helpful in ensuring that the process could be cost-effective. Moreover, it is also very important to avoid the practice of artificially increasing the amounts in dispute, or to add weak claims to the arbitration which extend, in an unnecessary manner, the duration of the arbitration.

Dosman: Cost management and predictability are a primary concern for parties using international arbitration. Careful attention at the contracting

stage, and again at the outset of an arbitration, can significantly reduce costs and increase efficiency. For example, parties may choose to explicitly incorporate guidelines or protocols that provide for a reduced disclosure burden. Once an arbitration has begun, it is critical to think through the various stages and potential disputes that may arise during the proceedings. Often, setting a hearing date at the very outset of the case can be a powerful tool in ensuring the efficiency of the process. Institutions have also been responding to users' concerns regarding the length of proceedings. Under the ICDR Rules, as revised in 2014, the default is for the final award to be rendered within 60 days of the close of the hearing. In addition, ICDR expedited international rules are available in certain circumstances, under which all submissions and the oral hearing – if any – must be held within 60 days of the procedural order, followed by a final award within 30 days of the close of the hearing. Similarly, the International Institute for Conflict Prevention and Resolution (CPR) offers accelerated rules for the resolution of commercial disputes.

Martinez: It is strongly recommended that the parties participate in the early stages of the process. By attending the administrative conference calls and the preliminary hearing, the parties can better understand the complexities of the case, the amount of requested information, the hearing schedule, and how the case will progress through to its conclusion. Parties can also opt to customise their arbitration agreement to save time and money. They can opt for the expedited rules, select a sole arbitrator, and perhaps waive the need for in-person hearings and have the dispute resolved on the documents only.

"By attending the administrative conference calls and the preliminary hearing, the parties can better understand the complexities of the case."

Luis M. Martinez,
American Arbitration Association

CD: Are there any particular issues that foreign parties need to consider when approaching arbitration in the Americas? What advice can you offer on managing the overall process?

Venegas: In Latin American countries, it is always important to understand the local market, identify the local law firms specialised in arbitration and make a proper assessment of the likelihood of recovering

any amount awarded. The best advice regarding the management of the overall process is to use the best local law firm to figure out the duration, costs and worst case scenarios before entering into arbitration. Once these factors are clearly defined, then it is easy to manage all the related variables of the arbitration.

Martinez: It is vital to be aware of the reputation of the administering institution that is being considered for their arbitration agreement and to know its policies and rules. The importance of staff cannot be overstated. The process can be customised to avoid surprises and to have a level playing field with the rules of the game clearly spelled out. That is the importance of having a well thought-out arbitration agreement administered by an institution with an established track record.

Yanos: Too often, foreign parties preparing for arbitration in Latin America assume that, if the arbitration is governed by the law of a particular jurisdiction, then counsel from that jurisdiction can handle the arbitration. They also tend to appoint a specialist in the law of the particular jurisdiction as arbitrator, without care as to how that legal specialist will interact with the other arbitrators or how counsel will be perceived by the arbitrators. Sometimes, the cost of the arbitration factors into these decisions. In our opinion, if the arbitration is worth bringing, it is worthwhile doing everything one can to prevail in the case. Bringing in counsel that is specialised in the field of international arbitration and allocating a realistic budget that is commensurate with the amount involved in the case is the best way to maximise the chances of success. If the client lacks the funds to pay for counsel with a track record commensurate with the value of the case, then there are alternative fee arrangements, including contingency fees and third party funding arrangements available to pay for the arbitration.

Dosman: As with any legal dispute, preparation is key. Both foreign and Americas-based parties will be sure to understand the legal framework governing the arbitration, including the national arbitration law and any applicable institutional rules. Any local practices with respect to procedural matters should be discussed with qualified counsel. For the overall process, institutions like the International Council for Commercial Arbitration (ICCA), the International Bar Association, and the Chartered Institute of Arbitrators have produced excellent guides and protocols.

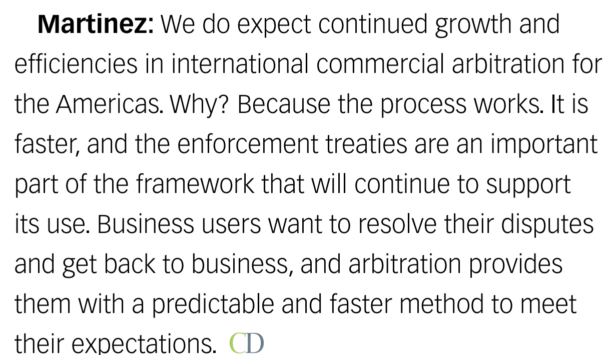
CD: Looking ahead, how do you expect arbitration in the region to develop over the coming years? Will the process continue to attract parties looking to resolve their commercial disputes?

Dosman: In the coming years, we expect to see growth in both the number and the complexity of international arbitration cases that are based in

the Americas. In terms of industries, international arbitration is commonly selected in matters relating to international construction, international energy contracts, and cross-border mergers and acquisitions. Arbitration also appears to be increasingly popular as a means to resolve disputes relating to intellectual property. Another interesting trend is the increase in investor-state related disputes being heard in New York, which traditionally have focused on Washington DC. Given the core attributes of the process – greater party autonomy, increased confidentiality, the potential to keep costs down – commercial parties are likely to continue to choose international arbitration in the Americas.

Yanos: We expect the economies in Latin America to continue to grow in the coming years. The shale gas and oil revolutions, together with the Brazilian pre-salt and the vast heavy oil reserves in Canada and Venezuela have ensured that both hemispheres in the Americas will play an even larger role in the energy business over the next 20 years than they did over the past 20 years. We expect the opening of the oil sector in Mexico to foreign investment to reap similar benefits. This means investment and a growth in related infrastructure. Furthermore, we expect investment in the Americas from Asia to increase even more in the coming years once the Trans-Pacific Partnership Agreement (TPP) is ratified. The TPP will further tilt the economic focus of the global economy away from the Atlantic Coast and toward the Pacific Rim. All of this increased business and trade will result in a massive increase in the use of arbitration.

Venegas: Arbitration will continue to evolve and attract new practitioners and companies. In several countries the right to arbitration is now considered as a constitutional right. This endorsement will surely play a role in increasing the trust that the state courts have in arbitration. A more experienced legal market – arbitrators, attorneys, academic investigators – will surely help to enhance the costs and timing of the arbitration proceedings. As always, once a proceeding proves to be beneficial in time, cost and quality, it will become more used. Therefore, there is no doubt that the future of arbitration in the region looks bright.



Martinez: We do expect continued growth and efficiencies in international commercial arbitration for the Americas. Why? Because the process works. It is faster, and the enforcement treaties are an important part of the framework that will continue to support its use. Business users want to resolve their disputes and get back to business, and arbitration provides them with a predictable and faster method to meet their expectations. CD

PERSPECTIVES

ARBITRATION AND EXPEDITED COURT PROCEDURES IN COMMERCIAL DISPUTES

BY **GREGORY BURTON**
> 5 WENTWORTH CHAMBERS

The Supreme Court of New South Wales has had a specialised Commercial List (at one point a separate Commercial Division) since December 1903, only eight or so years shorter than the time that such a list or its equivalent has existed in London. As one would expect, it has been marked, not only by specialised knowledge of commercial matters in the judicial officers assigned to the list, but also by the specialised procedures for expedited determination of commercial disputes. Other specialised lists are provided for, including technology and construction matters.

Expedited procedures include early consideration of reference out and mediation, the use of technology prior to the hearing and during the hearing, and potential for 'stopwatch' hearings with pre-allocated time blocs for aspects of the hearing. These enhance the broad directional powers in the usual Court rules and the underpinning legislation, with an overriding purpose (expressly legislated) to facilitate the just, quick and cheap resolution of the real issues in the proceedings. There is power for hearings 'on the papers' or with limited oral evidence and submissions.

Similar outcomes are achieved in other Australian superior courts in relation to significant commercial, construction and technology matters. In the Federal Court, for instance, there is the current

implementation of national practice areas (such as commercial and corporate matters with sub-specialties including international commercial arbitration) to coordinate on a national basis the existing case management by docket by appropriately-experienced judicial officers.

Arbitration in Australia, reflecting the federal political structure, has been governed by state and territory legislation for domestic commercial arbitrations and by federal legislation for international arbitration. The federal International Arbitration Act 1974 has long given the force of law to the UNCITRAL Model Law on International Commercial Arbitration, with appropriate complementary powers to courts, and has taken account of developments in the Model Law. The

state commercial arbitration legislation achieved significant uniformity in the 1980s and since 2010 has been almost entirely replaced by new substantially uniform legislation founded on the Model Law.

In recent decades, arbitral organisations in Australia (such as the recently refashioned Australian Disputes Centre) have implemented the same type of expedited rules that have also been developed by other arbitral organisations. These make provision for the same types of flexible procedures, with the same overriding rationale, as has been outlined above for the courts.

Given substantive equivalence of available mechanisms, something is required to deal with the critique of the arbitral process, compared with court commercial lists, that was made by Heydon J at the conclusion of reasons in the High Court of Australia in *Westport Insurance Corp vs. Gordian Runoff Ltd*: "The arbitration proceedings began 15 October 2004... This appeal comes to a close seven years later. The attractions of arbitration are said to lie in speed, cheapness, expertise and secrecy. It is not intended to make any criticisms in these respects of the [arbitrators and judges] for on the material in the appeal books none are fairly open. But it must be said that speed and cheapness are not manifest in the process to which the parties agreed. A commercial trial judge would have ensured more speed and less expense. On the construction point it is unlikely that the arbitrator has any greater relevant expertise than a commercial trial judge. Secrecy was lost once the reinsurers exercised their right to seek leave to appeal. The proceedings reveal no other point of superiority over conventional litigation. One point of inferiority they reveal is that there have been four tiers of adjudication, not three. Comment on these melancholy facts would be superfluous".

"In recent decades, arbitral organisations in Australia have implemented the same type of expedited rules that have also been developed by other arbitral organisations."

This is particularly necessary where there exists an acceptable alternative to arbitration for parties such as a connection of the dispute to a jurisdiction with a reputable commercial court whose decisions will be reciprocally and reliably enforced in jurisdictions where the losing party has assets.

The required solution may basically be in two areas of focus, which interact. The first is a clear support by the legislature and the courts for

arbitration if commercial parties choose it in their transaction documentation. This is already strongly apparent in Australia in extra-curial speeches and articles by senior judicial officers. The uniform adoption of the Model Law has narrowed the field of judicial review, appeal and intervention in arbitral decisions, except in support of the arbitral process (with opt-in and opt-out choices to enhance party autonomy) in sections 22-27 of the International Arbitration Act on matters such as subpoenas, compliance with tribunal orders, confidentiality, security for costs, interest and costs.

Court decisions in recent times have emphasised the limited role for the courts to intervene, including by not enforcing an arbitral award, except in support of the arbitral process and outcome. For example, on 11 August 2015 the NSW Court of Appeal in *Aircraft Support Industries vs. William Hare UAE LLC* confirmed that any challenge to enforcement of an award on the grounds of denial of natural justice required, in the arbitral context, that there be demonstrated real practical unfairness and injustice, such as failure of the arbitral tribunal to deal with a clearly articulated argument, as opposed to assertions in collateral material not pursued in final argument. The Court of Appeal also took into account the approach of international decisions on wording similar to that in the International Arbitration Act in concluding that part of an award can be enforced where another part of the award does not meet the requirements to enforce an award. The decision was consistent with earlier authority in the Court of Appeal and the Full Federal Court.

Further, on 14 October 2015 the High Court of Australia, in *PT Bayan Resources TBK vs. BCBC Singapore Pte Ltd*, upheld the power of a state Supreme Court to make a freezing order on local assets of a party to overseas litigation because the freezing order protects the process of registration and enforcement of the overseas judgment that emerges from the litigation. There appears to be no reason in principle that such an approach would not apply to a relevant international arbitration award made in a Convention country (the 1958 UNCITRAL Convention on the Recognition and Enforcement of Foreign Arbitral Awards), complementing the arbitral tribunal's powers under articles 17 *et seq* of the Model Law, particularly article 17J.

The second is to see, and if possible encourage, an attitude in parties that commercial advantage generally argues for support of arbitration even if in a particular instance a short-term benefit can be achieved by other tactics. A court can, for example, enforce under broad directions powers the determination of a dispute 'on the papers' or with restricted oral hearing, subject to rights of appeal about, for example, procedural fairness concerning the absence of an oral hearing. Under articles 19 and 24 of the Model Law, taking the same example, an arbitral tribunal has the power to do the same but only with the agreement or in the silence of both parties. Certain disputes are amenable to such

determination, quickly and cheaply, but only if the parties see the overall advantage in cooperation to make the process work in the way that optimally resolves the particular dispute and thereby enhances the process itself. A similar approach to other procedural issues and to the complexity of reasons required in the award is similarly apposite.

The two areas of focus run together. An approach by a supervising or enforcing court that enhances, within the permitted boundaries of the Model Law, what the arbitrator has done (and awards costs, perhaps on an indemnity basis if justified, against the losing party on that basis), as is occurring in Australia, may encourage the parties to take a sensible commercial approach and embrace the flexible procedures most adapted to their particular dispute. CD

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PERSPECTIVES

ENHANCING TRANSPARENCY: THE MAURITIUS CONVENTION ON TRANSPARENCY

BY **SARA CAPRUZZI**
> ASSOCIATION FOR INTERNATIONAL ARBITRATION

Transparency is one of the focal points in international investment arbitration. Its importance stems from the fact that investment treaty claims often concern and decide key public policy issues; thus, providing transparency in investor-state dispute settlement would develop public awareness and participation in disputes that deal with topics of public importance. For this reason, there is an increasing demand that the proceedings should be accessible and that interested third parties should be able to participate in them.

In 2014, the UNCITRAL Transparency Rules entered into force, providing for increased transparency in investor-state proceedings that are conducted under the UNCITRAL Arbitration Rules. The Rules include provisions on the publication of documents, open hearings and the possibility for non-disputing parties to make submissions. However, the Rules only apply automatically in disputes arising out of treaties concluded on or after 1 April 2014. For arbitrations that commenced before that date, the Rules apply only if the parties to the relevant treaty, or the parties to the arbitration, have agreed to their application.

Aware that the Rules would harmonise the settlement of international investment disputes, and to circumvent the issue of the scope of application of the UNCITRAL Transparency Rules, the UN General Assembly adopted in December 2014 the UN Convention on Transparency in Treaty-Based Investor-State Arbitration (the Mauritius Convention on Transparency). The Convention was opened for signature on 17 March 2015 and will enter into force six months after the date of deposit of the third instrument of ratification, acceptance, approval or accession.

> **"The aim of the Mauritius Convention is to extend the scope of application of the UNICTRAL Rules on Transparency to, eventually, the whole treaty-based international investment regime."**

The aim of the Mauritius Convention is to extend the scope of application of the UNICTRAL Rules on Transparency to, eventually, the whole treaty-based international investment regime. Therefore, the new Convention will make the UNCITRAL Transparency Rules applicable to all treaty-based investor-state arbitrations, also those brought before April 2014, independently of the applicable arbitration rules, thus establishing transparency as a general principle of international investment law.

One interesting feature of the Convention that is worth noting concerns the relationship between the Transparency Rules and most-favoured nation (MFN) provisions in investment treaties. MFN clauses have been defined by the International Law Commission as "a treaty provision whereby a State undertakes an obligation towards another State to accord Most-favoured Nation treatment in an agreed sphere of relation" (International Law Commission, Final Draft Articles on Most Favoured Nation Clauses, Yearbook of the International Law Commission, Vol. 2, pt. 2, 30th session, 1978, 16 (Art. 4), although not adopted by the UN General Assembly).

According to Article 2(5), it is not possible to invoke a MFN provision in order to apply, or to avoid the application of, the UNCITRAL Rules on Transparency. There had been debate among the drafters on whether to insert this provision in the Convention. There was a concern that its inclusion would have been as UNCITRAL was taking a position on whether a MFN provision could apply to require the same or better investment treatment to investors not only on substantive matters, but also on procedural ones. However, it has been clarified that UNCITRAL was not taking any positions on the matter. Besides the MFN exclusion, a party can still claim that, in accordance with the MFN article of the underlying investment treaty, the Transparency Rules should or should not apply; in that case, the tribunal will have to interpret the MFN provision at issue. Pursuant to Art. 30(3) and 30(4) of the Vienna Convention on the Law of the Treaties (VCLT), Art. 2(5) of the Mauritius Convention applies only when the respondent and the investor's home state are both party to the investment treaty and to the Transparency Convention. If that is not the case, the situation is less clear.

As mentioned above, the Mauritius Convention addresses a criticism that has frequently been raised against investor-state arbitration, which is the fact that investment tribunals often decide questions of public importance behind closed doors. More importantly, the relevance of the Convention arises from the fact that the widespread application of transparency would not only enhance the accountability of the underlying investor-state relations, but also enable better public control of the arbitral process. As noted by Schill, this would turn the Mauritius Convention into "an instrument with constitutional implications for the international investment regime" (Schill S. W., Editorial: the Mauritius Convention on Transparency, The Journal of World Investment & Trade 16, 2015).

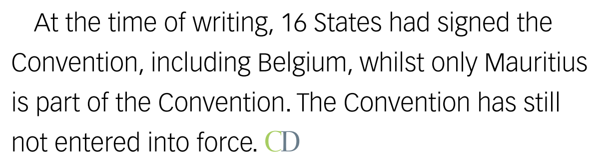
The same author has considered the establishment of transparency as a general principle of investment law as an approach that responds to the difficulties caused by "a piecemeal, treaty-by-treaty approach to investment law reform ... in light of the decentralised nature of investment law and investor-state dispute settlement". Therefore, the 'Mauritius approach' may become a model for the reform of certain issues of international investment law, such as introducing corporate

social responsibility or creating an appeals facility for investment treaty awards, without recurring to multilateral negotiations.

The Convention provides various ways of applying the Transparency Rules and gives parties considerable flexibility with regards to transparency commitments. Even though it does not consist of a revolutionary development, it still is a powerful instrument which can be considered without any doubt as an important "step towards greater transparency" (Shrilow, KluwerArbitrationBlog).

It is finally worth noting that, according to Article 3 of the Convention, parties have the flexibility to formulate reservations, and thus exclude investment treaties from the application of the Convention. Even though the Convention defines specific timings for the formulation and withdrawal of reservations, which grants a good level of flexibility, there may be doubts on whether the possibility to make reservations can defeat the purpose of Convention; thus it is still not sure whether further reforms may be necessary in the future. Moreover, doubts have been expressed as to whether the system of international investment arbitration is ready for full transparency: the states' reaction to the signature and ratification of the Mauritius Convention will give evidence on it.

At the time of writing, 16 States had signed the Convention, including Belgium, whilst only Mauritius is part of the Convention. The Convention has still not entered into force. CD



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PERSPECTIVES

INTERNATIONAL INSURANCE AND REINSURANCE ARBITRATION: A WORLD OF DIFFERENCE

BY **S.I. STRONG**
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Insurance plays a significant role in the global economy, generating trillions of dollars a year in revenue and safeguarding property and investments around the world. Given the importance of insurance to international markets, it might be safe to assume that parties and practitioners would have a detailed knowledge of how disputes involving insurance are resolved. However, even those who work in insurance law often know very little about these highly specialised matters.

This phenomenon is of course problematic for both parties (who may not appreciate the scope and nature of the dispute resolution options that are available to them) as well as lawmakers (who may be forced to make critical determinations about the content and shape of the law without a proper understanding of how various mechanisms operate in a particular context). Confusion is particularly prevalent in matters involving international insurance and reinsurance, since these disputes are often resolved through arbitration rather than litigation. Although it is impossible to provide a comprehensive overview of all of the relevant issues, it is useful to identify three main areas of concern.

Tensions between international and domestic law

The first matter to discuss involves tensions between international and domestic law. This issue is illustrated by the ongoing debate in the US about the extent to which the McCarran-Ferguson Act reverse pre-empts certain legal principles in international disputes. The concept of reverse pre-emption is well known in the US insurance industry and involves situations in which Congress defers to state authority, thereby allowing state law to trump (i.e., reverse pre-empt) federal law.

The McCarran-Ferguson Act has been held to authorise reverse pre-emption of the Federal Arbitration Act (FAA) in cases where individual US states prohibit arbitration of domestic insurance disputes. While this conclusion is incontrovertible in cases falling entirely under Chapter 1 (the 'domestic chapter') of the FAA, problems arise in international disputes due to questions involving the relationship between Chapter 2 (one of the 'international chapters') of the FAA and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). In particular, parties have questioned whether the McCarran-Ferguson Act permits reverse pre-emption in matters involving the New York Convention. If reverse pre-emption were allowed, then US courts could invalidate arbitration agreements involving international insurance and reinsurance.

Unfortunately, no clear answer exists, at least among US federal appellate courts. On the one hand, the Second Circuit has allowed the McCarran-Ferguson Act to reverse pre-empt the New York Convention in one decision dating back to 1995, although this opinion has been largely discredited and may no longer be good law. On the other hand, the Fourth and Fifth Circuits have held (in 2012 and 2009 respectively) that the McCarran-Ferguson Act does not reverse pre-empt the New York Convention, at least in certain circumstances. In both of these cases, the courts were guided by the pro-arbitration policy enunciated in both the New York Convention and longstanding US Supreme Court precedent involving international arbitration.

> "If reverse pre-emption were allowed, then US courts could invalidate arbitration agreements involving international insurance and reinsurance."

Tensions between different national laws

The second issue to consider involves the tension between different national laws. This issue is most easily seen in the context of Bermuda Form arbitration, although the issue also arises in other types of international insurance arbitration.

The Bermuda Form was developed in the mid-1980s as a result of a crisis in worldwide tort insurance markets. When traditional modes of insurance coverage failed, several leading providers created the Bermuda Form as a means of ensuring a relatively balanced approach to the interests of policyholders and investors while also avoiding various substantive problems associated with existing forms of tort insurance.

The most intriguing aspect of Bermuda Form arbitration for the purposes of the current discussion involves a jurisdictional split between procedural and substantive law. In particular, the Bermuda Form requires the substantive dispute to be decided pursuant to a modified version of New York law but requires the matter to be heard by arbitration seated in London and governed by the English Arbitration Act 1996.

Splitting procedural and substantive law is quite common in other types of international commercial arbitration and is therefore unobjectionable in Bermuda Form arbitration as a jurisprudential matter. However, certain practical problems can arise if parties do not understand and appreciate the

legitimacy of the Bermuda Form framework. Thus, a dispute arose recently as to which court has proper jurisdiction over matters ancillary to a Bermuda Form arbitration – the court in London, which was where the arbitration was seated, or the court in New York, which was the place of the law governing the substantive dispute. According to the English Court of Appeal, English courts retain curial jurisdiction over all Bermuda Form arbitrations. Although this decision might appear somewhat parochial, the English court's approach is consistent with standard procedure in other types of international arbitration and is therefore unproblematic from the arbitral perspective, even if insurers and insureds might find the outcome surprising.

Tensions between party autonomy and public policy

The third issue to consider involves tensions arising between the pro-arbitration policy exhibited by numerous countries in international commercial matters and policies supporting state regulation of insurance to promote the public interest. In particular, questions have arisen as to whether and to what extent private parties should be able to exercise personal autonomy to create dispute resolution mechanisms that may subvert or conflict with certain public values.

In many ways, this analysis is quite difficult. On the one hand, many countries reflect a heightened state interest in resolution of insurance disputes. On the other hand, the special nature of international insurance and reinsurance matters reflects a somewhat attenuated connection to domestic concerns, which suggests a diminished state interest in the outcome of these disputes. The discussion is further complicated by the fact that many countries have supported arbitration in international matters, even when a different result would arise in a domestic context. Although most jurisdictions appear to support arbitration of international insurance and reinsurance disputes, this policy debate is likely to continue.

Conclusion

The importance of the insurance industry to the global economy suggests a heightened need to scrutinise the manner in which international insurance and reinsurance disputes are resolved. In particular, parties need to be aware of the special nature of international insurance and reinsurance arbitration so that they will be in a better position to protect their interests and avoid costly and unnecessary litigation. CD

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PERSPECTIVES

ARBITRATING CORPORATE DISPUTES UNDER THE BRAZILIAN CORPORATIONS ACT

BY **ANA CAROLINA HORTA BARRETTO, SERGIO ANDRÉ LACLAU MARQUES AND MATEUS AIMORÉ CARRETEIRO**
> VEIRANO ADVOGADOS

On 26 May 2015, Federal Law No. 13,129/2015 amended the Brazilian Corporations Act (Law 6,404/76) to include a new article regarding arbitration of corporate disputes. The purpose of such amendment to the Corporations Act was to: (i) regulate the choice of companies to resort to arbitration through the inclusion of arbitration clauses in the company's bylaws; and (ii) offer more certainty to disputes involving shareholders and companies, representing an important step in the development of Brazilian corporate law and governance.

Despite the fact that since 2001 the Corporations Act expressly allowed Brazilian companies to include arbitration clauses in their bylaws, it was silent about whether shareholders who either expressly voted against the adoption of the arbitration clause or acquired shares after the inclusion of such

arbitration clause in the bylaws would also be mandatorily subject to such arbitration clause.

Some Brazilian practitioners and scholars claimed that if a company decides, in a general meeting of shareholders, to include an arbitration clause to its bylaws, only the shareholders who expressly accepted the inclusion of the arbitration clause were bound by it. Hence, shareholders who acquired their shares after the inclusion of the arbitration clause to the company's bylaws could not be forced to arbitrate their disputes, unless they sign a specific instrument of commitment accepting the arbitration clause. These opinions were based on the traditional principle that arbitration should be based on an express agreement of the parties and that the right to resort to Brazilian courts cannot be limited, except as the result of a clear and undisputed manifestation of will.

Notwithstanding, the majority of Brazilian practitioners and scholars, based on the principle that decisions taken in a shareholders' meetings shall observe the majority principle, admitted that such an arbitration clause would also be extensive to and bind shareholders who did not agree with its inclusion in the bylaws, as well as those who acquired their shares after the inclusion of the arbitration provision in the bylaws.

Federal Law No. 13,129/2015 brought such debate to an end through the inclusion of article 136-A to the Corporations Act. The Corporations Act now clearly states that the arbitration clause will become effective 30 days following the publication of the minutes of the general meeting of the shareholders that approved the relevant amendment of the bylaws. Furthermore, any shareholder who opposes the adoption of the arbitration clause is entitled to withdraw from the company.

"Any shareholder who opposes the adoption of the arbitration clause is entitled to withdraw from the company."

There are two exceptions to this right to withdraw from the company.

Firstly, it will not apply if the inclusion of an arbitration clause in the bylaws occurs as a condition for listing the company's shares in a specific stock exchange segment that requires a minimum free float of 25 percent. Although not expressly referred in the law, this provision aims to facilitate the listing of a specific company in the *Novo Mercado*

segment, which is a listing segment of São Paulo Stock Exchange (BM&F-BOVESPA) comprised by companies that follow certain best corporate governance practices. Among other requirements, listing a company into the *Novo Mercado* requires such company to: (i) include an arbitration clause in its bylaws; and (ii) have, at least, a 25 percent free float of its shares.

Secondly, the right to withdraw does not apply to holders of shares of publicly-held companies that meet market liquidity and dispersion criteria.

Despite the fact that such amendment concerns Brazilian companies only, it is internationally significant in view of the amount of investments that Brazilian companies have attracted in recent decade and its position in the global economy. A good and recent example is the case *In re Petrobras Securities Litigation* recently decided by the United States District Court for the Southern District of New York.

Petrobras, the Brazilian energy company, was suddenly caught in the eye of a corruption scandal of huge proportions due to an operation carried out

by the Brazilian Federal Police known as 'Car Wash'. The operation brought to light the fact that Petrobras arguably made false and misleading statements and omitted important information in its press-releases and year-end filings with the Securities & Exchange Commission.

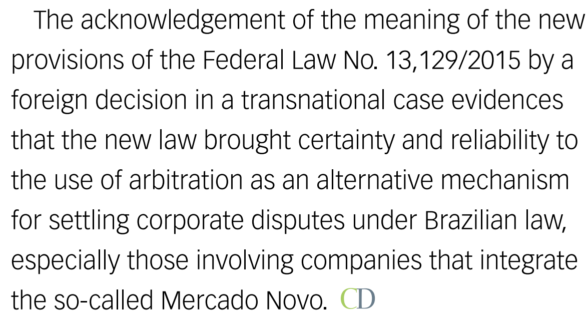
In view of the scandal, some shareholders who acquired shares in the New York Stock Exchange (NYSE) – by means of American Depository Shares – and BM&F-BOVESPA filed five separate class actions that were later consolidated into one amended complaint. In order to establish Petrobras' liability, the plaintiffs argued in summary that: (i) the corruption scheme resulted on the overpayment of several refineries, works and services and that, since the charges on fraud and bribery were made public worldwide, the value of the company decreased from US$310bn to US$39bn; (ii) the US Exchange Act sets out the liability of companies for the information they offer to shareholders and, in the case at hand, Petrobras published reports where its asset values were inflated by bribe payments and overcharges; and (iii) Petrobras made several false statements regarding the effectiveness of its financial controls.

However, Petrobras moved to dismiss the lawsuit, among others, based on the arbitration clause provided for in its bylaws stipulating that any dispute involving shareholders, managers, board members or the company itself should be settled by arbitration administered by CAM (*Câmara de Arbitragem do Mercado* or Exchange Arbitration Chamber) in the city of São Paulo, Brazil.

The claimants, in turn, argued that the arbitration clause was void on the grounds that a purchase of shares in a stock exchange is a 'take-it-or-leave-it' contract and they did not expressly agree to resort to arbitration to settle their disputes.

Petrobras then argued that considerations based on a 'take-it-or-leave-it' principle only apply to agreements involving parties that are not in equal positions, namely agreements signed under consumer law, where consumers do not have bargaining power regarding the company. According to Petrobras, Brazilian corporate law rules that the decisions taken by the company do not need to be unanimous, as they follow the interest of the majority of the shareholders.

Judge Jed S. Rakoff granted in part the motion to dismiss filed by Petrobras. Although not recognising the validity of the arbitration clause to investors who acquired Petrobras shares in the US by means of American Depository Shares, he found that: (i) the majority principle applies to shares acquired in BM&F–BOVESPA; (ii) the acquisition of shares cannot be considered a 'take-it-or-leave-it' contract; and (iii) the amendment of the Corporations Act strengthens the legal position that Brazilian law accepts inclusion of arbitration clauses in the company's bylaws and that such decision may be taken by the majority of shareholders.



The acknowledgement of the meaning of the new provisions of the Federal Law No. 13,129/2015 by a foreign decision in a transnational case evidences that the new law brought certainty and reliability to the use of arbitration as an alternative mechanism for settling corporate disputes under Brazilian law, especially those involving companies that integrate the so-called Mercado Novo. CD

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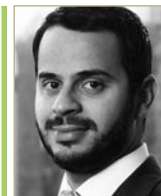

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PERSPECTIVES

PRO-ARBITRATION DECISIONS IN HONG KONG IN 2015

BY **ALFRED WU AND ANITA FONG**
> NORTON ROSE FULBRIGHT

Hong Kong courts have continued to demonstrate a pro-arbitration stance in 2015. We take a look at some of the recent cases including the first anti-suit injunction granted by the HK court to enjoin foreign proceedings and the first constitutional challenge of the Arbitration Ordinance.

Astro – the Hong Kong episode

In 2014, the Singapore Court of Appeal held in *PT First Media TBK v Astro Nusantara International BV* and others that, under Article 16(3) of the Model Law, a party that was dissatisfied with a SIAC tribunal ruling on a question of jurisdiction could withhold its challenge in the Singapore court until after further awards were rendered against it in the arbitration. In other words, a party could wait until the enforcement stage before raising its challenge on jurisdiction.

The Singaporean decision could be contrasted against the Hong Kong position. Back in late 2010, the Hong Kong courts granted orders giving leave to Astro to enforce the SIAC Awards in Hong Kong. The SIAC Awards were made against PT by the SIAC from May 2009 to August 2010. Despite the expiry of the time limit for it to do so, PT did not take any action to set aside the orders, but later when Astro obtained a garnishee order in Hong Kong against a loan due to PT from a third party, and upon PT obtaining a favourable decision in Singapore against the enforceability of a substantial part of the awards, PT applied to the Hong Kong Court of First Instance (CFI)

to set aside the orders together with an application for extension of time to do so.

In February 2015, the CFI rejected PT's application and held that it was a well-established principle of Hong Kong law that an award-debtor is under a general duty of good faith when seeking to resist enforcement of an award, which was wide enough to cover situations recognised as giving rise to an estoppel or waiver, notwithstanding the Singaporean decision on the unenforceability of a substantial part of the awards.

The court found that there was a lack of good faith in PT's conduct in deliberately reserving the jurisdictional challenge until the enforcement stage and not raising it during the arbitration proceedings. PT's delay in contesting enforcement was caused by a deliberate and calculated decision not to take action in Hong Kong.

Constitutionality of the Arbitration Ordinance

In March 2015, the Court of Appeal decided that, upon reading section 84(3) of the Arbitration Ordinance together with section 14(3)(ea)(v) of the High Court Ordinance, there could not be any appeal from a CFI decision refusing leave to appeal against a CFI decision allowing a Mainland arbitral award to be enforced. It was held that courts have a limited role in the enforcement of arbitral awards, and that it was a deliberate policy decision to restrict rights of appeal to safeguard parties' expectation of finality.

In another case in July 2015, the China International Fund Limited (CIF) applied to the Court of Appeal challenging the constitutionality of sections 81(4) and 84(3) of the Arbitration Ordinance. CIF applied to the CFI to resist enforcement of an arbitral award but failed. Its application to the CFI

for leave to appeal also failed. It then sought leave to appeal from the Court of Appeal arguing that, under Article 82 of the Basic Law (the constitutional document of Hong Kong) the power of final adjudication should be vested in the Court of Final Appeal and should not be limited at the CFI level.

This was the first time the provisions of the Arbitration Ordinance were subject to a constitutional challenge, and the Court of Appeal allowed a full hearing before a three-judge bench. On 12 August 2015, the Court of Appeal rejected the challenge, finding that the restriction of appeal to the higher courts was both proportionate and constitutional, and that the restriction was in line with the Ordinance's aims to provide a fast, final and binding dispute resolution process with limited intervention from domestic courts.

First HK anti-suit injunction to restrain foreign proceedings

In April 2015, the CFI held that Hong Kong courts would readily grant an anti-suit injunction to restrain the pursuit of foreign proceedings brought in breach of an agreement to arbitrate in Hong Kong, especially in circumstances where the injunction was sought without delay and the foreign proceedings were not too far advanced. The defendant would need to give strong reasons to the court why an injunction should not be granted.

The principle, according to the court, is that the parties should be held to their contract. Questions as to the balance of convenience or whether one forum is more appropriate than another are irrelevant. The fact that there might be a risk of parallel proceedings and inconsistent decisions would not necessarily deny an anti-suit injunction.

The forensic nightmare

Traditionally, Hong Kong courts have frowned upon issues in dispute between the same parties being determined in different fora. The modern approach makes the presumption that, unless they indicate clearly to the contrary, commercially-minded parties are likely to want all disputes resolved by the same tribunal.

"In July 2014, the CFI referred to the "forensic nightmare" of possible parallel proceedings in litigation and in arbitration."

In July 2014, the CFI referred to the "forensic nightmare" of possible parallel proceedings in litigation and in arbitration. This resulted from the

arbitration clause in the subcontract covering the defendant's counterclaim, but not the plaintiff's claim under the loan and guarantee agreements (which were related to but did not arise from the subcontract).

The court therefore only stayed the defendant's counterclaim in favour of arbitration but not the plaintiff's claim. Recognising that this left open the possibility of simultaneous litigation and arbitration proceedings, the court suggested that an appropriate case management decision might be to order a stay of the claim pending arbitration to avoid possible inconsistent results and duplication of time and resources.

Hong Kong court summarises enforcement principles

In September 2015, Mimmie Chan J. dismissed an application to set aside an order to enforce an arbitral award on the basis that the application was unsupported by evidence and was submitted out of time.

The court held that the respondent in that case had made their application without stating in the summons or in the affidavit the precise grounds on which they rely, despite their knowledge of and participating in the arbitration, and their notice and knowledge of two previous arbitral awards.

As a result, the court held that the application was an abuse of court process (applying *Free Form Construction Co Ltd v Shinryo (Hong Kong) Ltd* [2009] 3 HKC 415). The court also held that the Respondent had brought a meritless application in an attempt to delay and frustrate the enforcement of the arbitral award and has breached its duty of good faith. In terms of costs, the court adopted the usual approach in Hong Kong of ordering the unsuccessful party to pay costs on an indemnity basis.

Chan J. formulated 10 general principles that the Hong Kong courts will apply when dealing with enforcement of arbitral awards, which endorsed the need for minimal judicial intervention, as established by the leading case *Grand Pacific Holdings Ltd v Pacific China Holdings Ltd* [2012] 4 HKLRD 1 (CA). Chan J.'s judgment reinforces the strong pro-arbitration stance of the Hong Kong courts, an approach which is consistently adopted and is "demonstrably clear in the authorities". CD

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PERSPECTIVES

THE NEW INVESTMENT COURT SYSTEM: PANACEA FOR THE FLAWS IN THE CURRENT ISDS MECHANISM?

BY **NICAT ƏHMƏDLI**
> ASSOCIATION FOR INTERNATIONAL ARBITRATION

The EU Trade Commissioner, Cecilia Malmström, in a concept paper published in May 2015, proposed the establishment of a new Investment Court System (ICS) which will hear investment disputes arising between investors and states. The new Court is intended to replace the current ISDS system and will include an appellate mechanism. The EU Commission intends that one permanent court will resolve the defects existing in the current ISDS system and silence the objections raised against it. This paper comments on and questions whether such a development is necessary and capable of fully covering the alleged flaws in the ISDS system. It will examine to what extent the proposed single court can overcome the problems regarding the independence and impartiality of arbitrators. Next, the paper challenges the alleged need to include an appellate mechanism in the new ICS.

On 5 May 2015, the European Commission proposed the new ICS for the Transatlantic Trade and Investment Partnership treaty and other EU trade and investment negotiations. Among the main elements of the reform that were proposed by Ms Malmström, the most noteworthy was the initiative to set up a permanent International Investment Court. In October the Commission published detailed draft proposals for the investment chapter in the TTIP. The chapter outlines the basis for the establishment of the International Investment Court which would resolve disputes under the TTIP.

It was the hefty criticism of the current well-established ISDS system which triggered this initiative. Numerous non-governmental organisations, mainly from Europe, raised the concern that standard arbitration proceedings under the ISDS regime favoured investors over states, sometimes halting the enactment of legislations proposed by democratically elected governments.

A lack of transparency in and monitoring by the public and the press of these proceedings were also criticised. After the well-organised public resistance against ISDS had become so powerful, threatening the ongoing TTIP negotiations, the EU Commission proposed the ICS as a strategic move to sustain the success of the attractive trade treaty between the US and the EU.

The EC is of the opinion that the new ICS will be capable of transforming the current ISDS system, which gives a great degree of autonomy to disputing parties in that they can appoint the arbitrators of their own choice. It is expected that the draft proposal will be reviewed, scrutinised and, if necessary, amended in next few months. Nevertheless, it needs to be asked whether the proposed ICS can be a real panacea for the alleged flaws present in the ISDS system. In other words, will the envisaged Court be structured well enough to address and effectively tackle those flaws? Or, in a nutshell, is the establishment of new ICS a desirable course of overcoming the objections raised against the ISDS system?

One of the prominent objections raised against the ISDS system revolves around arbitrators' impartiality and independence. Flowing from the party autonomy principle, parties to an investment dispute are free to select the arbitral tribunal of their own wish.

Current ISDS arbitrations are heard by a select few individuals who often act as lawyers for parties in similar cases, leading to serious doubts over their impartiality. As a targeted solution, Article 11(1) of the draft proposal provides that judges, upon appointment, "shall refrain from acting as counsel in any pending or new investment protection dispute under TTIP or under any other agreement or domestic law". The critics of the investment arbitration system contend that it is not suitable to address sensitive public policy issues there, as the current method of appointing arbitrators can lead to pro-investor or pro-state bias. To paraphrase, desire to be reappointed in future cases may cause bias in the decision-making of arbitrators. Thus, it is believed that the security of tenure frees an arbitrator from his or her self-interest, removing the possibility of one saying that the arbitrator was

"One of the prominent objections raised against the ISDS system revolves around arbitrators' impartiality and independence."

induced to adjudicate in a certain predetermined way. In contrast to arbitrators, the impartiality and independence of judges are not often called into question as they do not typically have ties with an appointer.

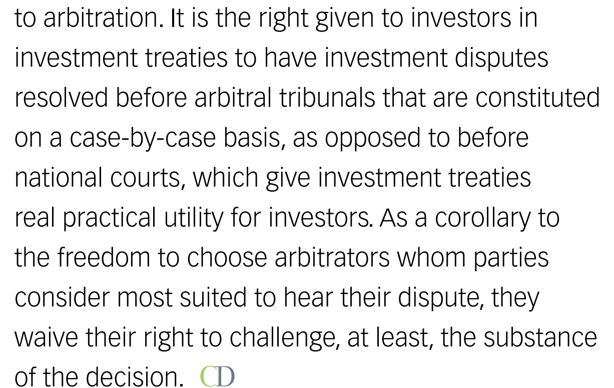
When examined carefully, these critiques of arbitrators often turn out to be unfounded allegations. The scepticism regarding arbitrators' impartiality and independence are based on generalised distrust and assumption of bad faith. Even if the draft proposal includes a code of conduct listing ethical and professional requirements expected from arbitrators, there have usually been several checks and mechanisms ensuring that the arbitrators do not fall foul of conflict of interest claims. The International Bar Association's (IBA) Guidelines on Conflicts of Interest in International Arbitration 2014, for instance, can be mutually chosen by both parties to apply, addressing potential conflict of interest issues. Also, arbitrators have a duty to disclose information that could cast doubts on their ability to render an impartial and independent award. Although it is rightly argued that arbitrators obtain their living by arbitrating, and are therefore dependent on the fees earned from the number of cases they have, one cannot not overlook the fact that their reputation is their most valuable asset. For an arbitrator to be said to have ruled not upon his legal judgement, but upon the interests of his appointer, would cause him to lose the chance of being reappointed. Hence, professional reputation is the best guarantor for an arbitrator of a successful career, since he or she is not blessed with security of tenure.

Moreover, the Commission's attempts to ensure that investment protection rules do not undermine the legitimate right of states to regulate, has tipped the balance in favour of states compared to investors. One of the underlying concerns behind the proposal for the ICS was that the current ISDS system is pro-investor. Contrarily, the proposed method of electing judges for the International Investment Court renders it pro-state. Article 10(3) of the draft text provides that "the Parties... shall... appoint the members of the Appeal Tribunal". This means that the claimant, namely, the investor, will have no say in the election of arbitrators, while there being huge likelihood that the states will appoint judges matching their criteria. Unless those provisions on the election and appointment of judges are revised, investors would, theoretically, be less prone to take their disputes to a standing court where they have had no say in the selection of judges.

Article 9(5) of the Draft Proposal allows for the reappointment of judges after one six-year term. It is widely accepted that an adjudicator enjoying power of jurisdiction and appointed for life is less concerned about the consequences, controversies and side effects of his or her decision. But judges with re-election prospects might moderate their decisions and opinions, which could attract criticism

and negative publicity, in order not to jeopardise their chances of being re-elected. Thus, in order for the security of tenure conferred to those judges to result in the highest quality of decision-making, the Commission needs to think twice about giving room to such provision in the final form of the TTIP.

The Commission in its concept paper expressly indicates that "an appellate mechanism has clear added value in ensuring consistency and predictability of the system". It is believed that the interpretation of the same treaty provisions by different tribunals chosen for each case leads to a great deal of inconsistency. Despite the support from some EU stakeholders for the creation of an appellate mechanism, it could indeed undermine the principal reason why disputing parties resort



to arbitration. It is the right given to investors in investment treaties to have investment disputes resolved before arbitral tribunals that are constituted on a case-by-case basis, as opposed to before national courts, which give investment treaties real practical utility for investors. As a corollary to the freedom to choose arbitrators whom parties consider most suited to hear their dispute, they waive their right to challenge, at least, the substance of the decision.

Nicat Əhmədli
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ONE-ON-ONE-INTERVIEW

ENTERPRISE RESOURCE PLANNING LITIGATION

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Mark P. Ressler, who leads the Software Litigation group at Kasowitz, Benson, Torres & Friedman LLP, has established the country's leading practice devoted to litigation arising out of the business disruption and financial losses caused by failed software implementations, particularly those involving Enterprise Resource Planning (ERP) business software. Mr Ressler has become counsel of choice for companies and governmental entities seeking to recover from ERP vendors – including ERP software providers and consulting firms implementing ERP software – in connection with mission-critical projects plagued by delayed or disastrous go-lives, skyrocketing costs, deficient project management, missing functionality, defective interfaces and excessive customisation.

CD: Could you provide an insight into the recent proliferation of litigation in the enterprise resource planning (ERP) space?

Ressler: ERP litigation has surged over the last five-plus years, for several reasons. First, competition from alternative business software platforms has led some ERP vendors to generate revenue by taking on certain projects they should have avoided. As a result, they've been increasingly unable to deliver the promised functionality at all, or deliver it on time and on budget. Second, since the 2008 financial crisis, companies are less inclined to tolerate the business disruption and financial losses caused by failed ERP projects. Third, the embrace of ERP by governmental entities has resulted in a spate of failed implementations and accompanying lawsuits at the state and municipality level. Fourth, companies now realise that through litigation, they can recover from ERP vendors that botch implementations – companies don't have to accept costly delays, ballooning costs, missing functionality, expensive change orders, and so on.

CD: What are some of the common reasons behind failed ERP software implementations?

Ressler: The first step in an ERP engagement is to investigate what went wrong on a project and why. Some projects fail because vendors overpromise and under-deliver regarding their consultants' experience or their software's functionality. Sometimes the software itself is the problem, especially when an ERP provider attempts to penetrate a new industry or develop functionality for challenging business processes. Usually, however, projects fail not because of an intrinsic software problem but because of mistakes in the implementation. Botched implementations result from deficient project management, as consulting firms fail to apply an appropriate implementation methodology. Project management lapses are reflected by, among other things, failure to assign an appropriately skilled and experienced team of consultants, failure to conduct

> **"Companies must conduct intensive due diligence in selecting their ERP solution and the consulting firm to implement it."**
>
> *Mark P. Ressler,*
> *Kasowitz, Benson, Torres & Friedman LLP*

sufficiently robust testing, slippage between project phases – for example, the build phase begins before the design phase is completed – and failure to identify, manage and mitigate project risks.

CD: In your opinion, what initial steps should a company take to identify the business risks associated with implementing an ERP software solution?

Ressler: Companies must conduct intensive due diligence in selecting their ERP solution and the consulting firm to implement it. During the selection phase, they need to ensure that vendor candidates are acutely familiar with the business processes at issue. They need to require consulting firms to identify the individual consultants who will be assigned to the project, and provide specific information about the consultants' prior experience. What projects did the consultants work on previously? What roles did they play? Moreover, vendors must be pressed for details about how they intend to address functional gaps. What level of customisation is required? Will the software's core code be modified? When it comes to selecting ERP vendors, companies should ignore the Rolling Stones' admonition that "you can't always get what you want". You always want and you always need the 'A-Team'. That's what consulting firms promise, but don't always deliver. The 'B-Team' can doom a project.

CD: Could you outline the range of potential damages facing parties responsible for a failed ERP implementation?

Ressler: The potential damages can be substantial. While ERP contracts typically contain provisions limiting damages to a return of fees, such damages caps can be avoided by proving that the ERP vendor fraudulently induced the contract. If the project was cancelled before go-live, recovery might include fees paid to all project vendors, software licence fees, amounts related to the company's internal project-related spend, and, under some circumstances, lost profits stemming from delays in meeting a strategic plan. If the project suffered through a failed or problematic go-live, recovery can also include fees paid for stabilisation and remediation work, and lost profits stemming from cancelled orders, missed shipments, failure to invoice, impairment of expansion or acquisition plans, and so on.

CD: To what extent can the blame for a failed ERP software implementation be apportioned? Should responsibility reside at the CIO, CFO level or elsewhere?

Ressler: In our cases, the blame lies with the ERP vendors. Companies that lack ERP implementation

skills and experience pay ERP vendors millions of dollars. ERP projects fail because ERP vendors did not provide the implementation services they were hired to provide. The ERP vendors, meanwhile, sometimes try to shift the blame onto the clients while minimising their own role and invoking the misleading mantra of shared responsibility, which is usually another way of trying to blame the victim. Our clients rely on the evidence to overcome blame-the-victim defences.

CD: What advice can you offer to companies on managing the ERP litigation process? Are there any particular strategies that can be deployed?

Ressler: Just as ERP implementations succeed or fail based on effective project management, so too do successful ERP litigations depend on the right team of attorneys and experts who can apply the skills and experience they've developed on prior ERP cases. There's no room for a learning curve when it comes to litigating ERP cases. Strategies include a thorough pre-complaint fact investigation to ensure a well-pleaded complaint, using as technical experts a team of ERP consultants who specialise in evaluating and rescuing failed ERP projects, using as a damages expert an economist who specialises in losses stemming from failed ERP projects, focusing in discovery on the precise kinds of internal ERP vendor documents that will be the most incriminating, and deposing the ERP vendor witnesses who, based on their project roles, will provide the most incriminating testimony.

CD: How do you envisage the ERP litigation landscape unfolding in the coming 12-18 months? What trends and developments do you expect to see?

Ressler: I expect the ERP litigation docket to grow for the foreseeable future. Some consulting firms will continue to engage in 'bait-and-switch' sales tactics, promising the 'A Team' and delivering anything but. Some software providers will continue to make promises about functionality they should not be making. In the meantime, key constituencies – boards, analysts, activist investors and private equity owners or acquirers – will continue to demand that mission-critical ERP projects are completed successfully, on time and on budget. That means that in-house counsel and senior leadership need to be proactive in monitoring project progress and holding ERP vendors' feet to the fire at the slightest sign of delays or issues. Gone are the days when the business side could simply delegate ERP projects to the IT team and check in again after go-live. Increased involvement in ERP projects by in-house counsel and the executive suite is a positive trend that will likely intensify. CD

PERSPECTIVES

THE ROLE OF INSURANCE IN LITIGATION

BY **MATTHEW WALKER**
> BURGES SALMON

The use of insurance in the context of litigation is not a new concept and in some sectors, such as construction or shipping, businesses are very familiar with how it operates and the considerations that go with that. However, in recent years insurers have started to provide insurance in an increasingly wide range of sectors, and businesses, whether acting as claimants or defendants, need to be aware of how insurance and litigation interrelate.

The benefits of insurance in relation to litigation risks should not be underestimated. For defendants it can give comfort that their balance sheet will not suffer if the claim is successful. For claimants it can be a means to recover a loss quickly and without the need to resort to expensive litigation.

Businesses therefore need to keep track of the insurances they have in place, the risks they cover, and the policy conditions that need to be fulfilled in order to successfully claim on the policy.

Where is insurance likely to arise?

Many of the insurance products that cover the risk of a business being sued are well known: for example, professional indemnity, public liability, employer's liability and so on. However, insurers also provide insurances that can be claimed on in lieu of having to bring a claim against a third party – for

example: (i) breach of seller's warranty in a corporate transaction, known as warranty & indemnity insurance; (ii) property title infringements, known as title risk insurance; (iii) failure by creditors to meet debts, known as credit default insurance; (iv) defaults by tenants under the terms of a lease, known as a tenant default insurance; and (v) insurance against property damage, such as property and contractors all risk insurance.

As a consequence, when a business becomes aware of a potential problem or dispute, it should turn its mind to whether it has any insurance policies

that may be relevant to claims the business may receive and to claims it may want to make.

It is also important to note that some insurance policies can be briefly described as, say, "professional indemnity policy for financial advisors" when in fact they also offer cover against a wide range of risks beyond professional negligence. For example, such policies can also cover D&O risks, breaches of data protection and confidentiality, costs incurred in regulatory investigations, and losses arising from third fraudulent instruments.

It is therefore advisable that businesses with a significant amount of insurance coverage should try to keep an up to date record of their insurance policies and the particular risks they cover.

"Businesses with a significant amount of insurance coverage should try to keep an up to date record of their insurance policies and the particular risks they cover."

Claiming on the businesses insurance?

Where a business identifies an insurance policy that may be relevant to the issue or dispute at hand, it is imperative that the business makes contact with the insurer as quickly as possible. There are a number of reasons for this.

First and foremost, nearly all insurance policies require the policy holder to provide the insurer promptly with formal notification of a claim. The manner in which a notification is to be given and the consequences of non-compliance vary from policy to policy, but in many cases a failure to make a valid notification can permit the insurer to decline the claim.

In addition to the requirement to make a notification of a claim or circumstance, insurance policies usually contain claims cooperation provisions that the policy holder must comply with throughout the life of the claim. Such provisions can be expressed in various different ways but commonly they include requirements that the policy holder: (i) must not disclose the existence of the insurance; (ii) must not admit liability for a claim against it; (iii) must not do anything that could prejudice the insurer's ability to handle the claim; and (iv) must not do anything that could prejudice the insurer's ability to pursue recoveries from third parties who are ultimately responsible for the loss.

These conditions are often found in policies that insure third party claims made against the policy holder (e.g., liability policies) but also in policies that cover losses suffered by the policy holder directly (e.g., property insurance).

For policies falling into the latter category, the obligation to not prejudice the insurers' ability to recover losses from third parties is very important. For example, where a business suffers damage to its premises due to a fire caused by negligent contractors, the business will be primarily concerned with making a recovery on its property insurance first, rather than suing the contractor. However, in doing so the business must be careful that they do not do or say anything that could release the contractor from a potential claim. If the contractor has been negligent the insurer may want to bring proceedings in the businesses name to claim damages (this is sometimes referred to as a right of subrogation).

Businesses should take note that the Insurance Act 2015 (which comes into force in August 2016) will make substantial changes to insurance law and should limit insurers' ability to decline claims.

Insurance held by the other side

In addition to making sure that a business has taken maximum advantage of its own insurance, a business involved in litigation should give consideration to what relevant insurance the other side may hold.

This is particularly important to consider when a business is bringing a claim. Most businesses and professional advisers carry various forms of liability insurance, which gives a claimant comfort that there is a pot of money available to pay compensation. However, the presence of insurance is not an automatic route to riches and the following points should be borne in mind.

Where a liability insurer is faced with a claim against its policy holder, one of the first things they will do is assess the cash 'reserve' it should set aside for the claim. Broadly, speaking the reserve will be calculated by considering the maximum value of the claim (plus costs) in the context of the insurer's view of the claim's merits. Once that claim is set, the money is set aside as a provision in the insurer's accounts and cannot be put to other uses. Generally speaking, once the reserve is set, the insurer starts to form a view of the range of funds it may pay to settle or dispose of the claim. It can be difficult to convince an insurer to increase its reserve.

From a claimant's perspective, therefore, where a claim is being made against an insured defendant, it is critical that the claim is set out at its highest and as compellingly as possible in order to encourage the insurer to set a high reserve. This will make it easier to encourage a higher settlement out of the insurer as the claim progresses.

For similar reasons, an insurer will not necessarily settle a claim early on, even where the initial merits seem strong. The insurer may need to be persuaded

that the claim presents it with a real risk and the claimant is not trying to make a quick recovery but without having to incur any costs.

As a result, insurers will sometime require a claim to progress a reasonable distance into formal proceedings in order to 'test the claimant's mettle', before engaging in substantive settlement discussions. Businesses should therefore be wary of entering into litigation against insured defendants in the hope that the insurer will happily agree a quick settlement – they may put up more of a fight than you expect. CD

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ONE-ON-ONE-INTERVIEW

THE FUTURE OF LITIGATION FUNDING

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Jonathan Barnes' family business was cotton spinning in the north-west, but he started his career in the law. He specialised in commercial property and was a partner at two City law firms. In 2006 Mr Barnes joined former client Woodsford Consulting as a director and led the successful sale of Europa Park, Central Europe's premier single location logistics and distribution centre, against the backdrop of a deepening credit crunch. Mr Barnes was a key player in Woodsford's decision to enter the litigation funding market, and has been instrumental to the success of the venture.

CD: Reflecting on the last couple of years, could you provide an overview of the litigation funding landscape? What do you consider to be the key developments shaping the market?

Barnes: The market continues to grow and become mainstream. Claimants and their lawyers are becoming more familiar with litigation funding, and in turn the demand for funding from those with good claims is increasing. To meet that demand, new capital has found its way into the sector at all levels. There are a number of new entrants looking to fund a higher volume of smaller claims. In the market for higher value claims, the professional regulated funders compete with others that fund on a more *ad hoc* basis, although it remains to be seen how the well-publicised loss of over £30m in Excalibur will affect the appetite for *ad hoc* funding. It may be that at least some *ad hoc* funders will withdraw from the market, alternatively seek to deploy their capital through the professional regulated funders. In any event, the winners will be those who allocate significant capital sums most prudently over the long-term.

CD: What are the potential advantages of litigation funding? Are there any drawbacks that parties might need to consider?

Barnes: Litigation funding facilitates access to justice and for some claimants the main advantage is that they are able to bring a meritorious claim that would otherwise flounder. For those with good claims and financial resources, the attraction is risk management. They can determine, at the outset, exactly how much financial resource they are prepared to put into a claim, in return for sharing a successful outcome. Provided the legal team is also willing to meaningfully share financial risk, another significant advantage is the alignment of the parties' financial interests. The traditional, hourly rate, billing approach can lead to a misalignment between lawyers and client. By definition, disputes are stressful. Claims evolve and there are up and downs. Funding involves introducing at least one more party into the equation. Get that wrong and, as with any 'partnership', cracks start to appear – a potential drawback.

CD: What types of litigation funding solutions are on offer to parties?

Barnes: The 'traditional' model uses a combination of discounted legal fees, often with an uplift on success, own costs cash funding from a funder, for legal and experts fees, and after-the-event (ATE) insurance for the potential adverse cost liability, if the claim fails. Some funders have developed 'hybrid DBAs' – a contractual arrangement that allows the lawyers to share the

funder's success fee and which can unlock certain claims. Many funders will consider funding a basket of claims through an individual law firm, which can be used to fund smaller individual claims and diversify the funder's portfolio of claims. Some will also give a contractual indemnity for adverse costs as an alternative to ATE insurance. The attraction for the claimant is that there are no insurance policy conditions to fall foul of should the indemnity be called on.

CD: Are there any scenarios where the use of litigation funding may not be relevant or suitable?

Barnes: Litigation funding is not suitable for unmeritorious claims, or claims where the likelihood of financial returns is obviously outweighed by the risks and costs involved in the claim.

CD: What general advice can you offer to parties seeking litigation funding? What steps should they take when embarking on this course of action?

Barnes: Parties seeking funding need to do their due diligence. Make sure that your funder really understands litigation and is itself well funded. There are currently seven members of the Association of Litigation Funders (ALF) and which have, therefore, signed up to the voluntary code of conduct approved by the Civil Justice Council. Most claimants need look no further. In particular, ALF members must meet a minimum capital adequacy requirement, of at least £5m from 2016, and may not withdraw from a funded claim without good reason. Funders come from different backgrounds – broadly, the law, insurance or finance – and can have distinct tastes. Make sure that your funder understands the underlying asset – litigation – and has a successful track record funding claims like yours. Be aware that litigation can include a very broad range of claims, from simple English High Court contractual disputes to environmental or securities class actions in the US, the Netherlands or Australia, Bilateral Investment Treaty arbitrations against sovereign states in Washington or Stockholm, and everything in between. The right funder will have valuable in-house expertise and experience and can be a real ally for the claimant and his team.

CD: To what extent are you seeing a rise in alternative fee arrangements between corporations and law firms? Can you outline some examples?

Barnes: 'Magic Circle' law firms maintain that their clients continue to enter into open-ended commitments to pay hourly rates. For a corporation that might be put out of business by a particular claim, this might be appropriate. However, the reality for almost all companies and law firms is that

alternative fee arrangements are the norm. Clients are increasingly expecting their lawyers to come to them with a creative funding solution that goes well beyond discounted headline rates. External funding can fit nicely into the equation by giving the client certainty in relation to the overall cost of the claim and help the law firm by paying at least part of its work in progress as the litigation proceeds. We have recently seen a US law firm grab a significant chunk of a discreet new business area by offering potential clients a range of options.

CD: To what extent have recent regulatory developments impacted on the litigation funding space? Can we expect to see any rule changes in the near future?

Barnes: The US Chamber of Commerce's anti-litigation funding campaign on behalf of its big corporate members continues. It seems to have prompted interest and questions from two US senators and, in turn, a robust defence from funders. The position is much the same as in 2009 when Lord Jackson's Review of Civil Litigation Costs found that most litigation funding agreements were between well advised commercial entities and formal regulation was unnecessary. In any event, if a regulator can be persuaded to take an interest in the sector, most professional funders don't anticipate compliance issues so are sanguine about the prospect.

CD: How do you expect litigation funding to unfold over the next 12 months or so? Are there any particular trends you expect to see?

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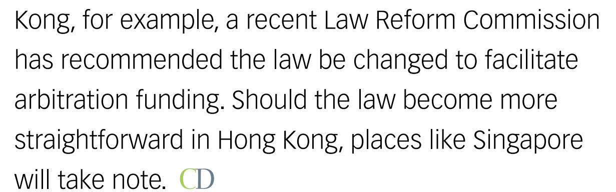
>
> *Jonathan Barnes, Woodsford Litigation Funding*

Barnes: In the UK, we will see a funded competition claim following the Consumer Rights Act 2015. This Act introduces US-style opt-out class actions to the UK for the first time. Follow-on claims, after a Competition Authority infringement decision, involving a relatively large number of claimants and, therefore, a high total claim value, will be attractive to funders if law firms can evidence the will to not let costs get out of control. Beyond the UK, we will see an increase in the number of jurisdictions that

recognise the access-to-justice benefits of litigation funding, and therefore a growth in hospitable markets. There are some jurisdictions that continue to struggle with the English medieval legal doctrines of maintenance and champerty, but ultimately the tide is turning in favour of litigation funding. In Hong Kong, for example, a recent Law Reform Commission has recommended the law be changed to facilitate arbitration funding. Should the law become more straightforward in Hong Kong, places like Singapore will take note. CD



PERSPECTIVES

THE ENVIRONMENT FOR RESOLVING INTERNATIONAL BUSINESS DISPUTES IS EVOLVING

BY **SUSANNE SCHULER**
> CEDR

Earlier in 2015 in London the Court of Appeal Judge, Lord Jackson, presented himself to a group at the Middle Temple Inn of Court in London to elaborate on the reforms in his namesake report. The Jackson Reforms, initiated two years back, aimed to re-imagine the civil justice system in the UK through over 100 recommendations, most of which have been implemented by this point. But what reforms did the UK justice system need?

The UK legal system, particularly compared to that of other European countries, is rife with high hourly fees, salaries and premiums at the cost of a fair legal system, especially for those who cannot fiscally afford to navigate its narrow channels, a situation which was a source of much dissatisfaction in the business community.

Furthermore, as the Jackson reforms demonstrate, the cost of justice has been put at the centre of the legal system debate whereas a discussion more focused on producing effective outcomes might better serve its corporate users.

When Lord Jackson gave his talk at the Middle Temple about the reforms, the focus was laid on two main points – the importance of cost management

and budgeting before litigation begins, and the need for the promotion of Alternative Dispute Resolution (ADR) methods in the traditional justice system. These two principles, while perhaps sounding rather broad given the point of the Jackson Reforms, actually lay out the foundation for reforming the system to allow equal access to justice across society.

When one embarks on a significant project, such as a corporate merger or acquisition, or a long-term investment proposition, one of the first things taken into consideration is the cost. Strict budgets are drawn up and signed off, and tables of potential risks are discussed, built-in and mitigated. It seems that common sense would have us wanting to know the price placed on hiring someone else to complete a service for us – and yet, with litigation, this has not been the case. The Latin phrase *'Iudex non calculat'* (which translated means 'a legal professional does not calculate') might seem to poke a bit of fun at the legal profession, but in fact, it has always been rare for litigators to sit down with clients to discuss the cost of legal representation throughout the justice process. The lack of a transparent cost hierarchy for the claim being taken to court has kept it from being a viable option for the large part of society that cannot necessarily afford to pay outlandish lawyer fees – and especially when those fees are not necessarily understood or known in the first place.

Looking at cost transparency as a lone solution, however, might be considered similar to bailing water out of a sinking boat rather

than plugging the hole – while budgeting and cost management can mitigate some of the issues allowing full access to the UK justice system, making the numbers visible and accurate does not repair the fact that litigation is an expensive option. Court cases can go on for years, and lawyer fees, no matter how transparent, are high. Court cases also place a high amount of stress on the individuals involved, consuming time that could be spent elsewhere more productively, and preventing parties from looking forward – rather than backward.

Take a case of an international corporate acquisition and alleged breaches of a Stock Purchase Agreement and various warranties. Are the parties best served by testing out through litigation and the court process who is right and who is wrong – which would most probably take years, tie up investment funds and management focus? Fortunately for the parties, a contract clause directed them to mediation in the first instance (a survey undertaken by CEDR in 2013 of in-house attitudes to commercial mediation suggests that 80 percent do use some form of escalation or ADR clause in their contracts). This led to an agreement after a two-day mediation, both parties having saved considerable time, energy and funds but, probably more importantly, both commenting on "the reasonable basis on the reached agreement which was satisfactory to both parties".

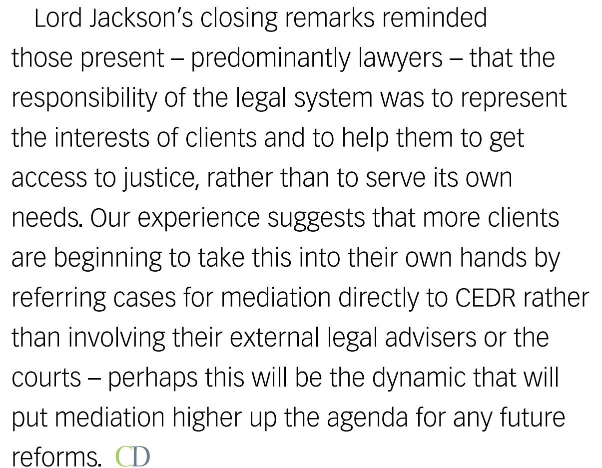
It is here that Lord Jackson's suggestion of promoting ADR within the courts might be considered the option that actually repairs the hole in the boat. ADR, the umbrella term which encompasses mediation, among others, allows the process of solving a problem to focus on the clients, rather than on the legal professionals. The benefits of mediation are several, but in the context of the cost of justice, there is one that stands out in particular – time.

"It seems that common sense would have us wanting to know the price placed on hiring someone else to complete a service for us – and yet, with litigation, this has not been the case."

Mediation is known in the legal world for taking a minute amount of time compared to litigation – between preparatory time and actual time spent in mediation; this number might range from 20 to 40 hours. This alone brings down the cost significantly. Because a mediation focuses on finding

an agreement between parties that addresses their needs rather than their positions, clients are more able to move past the back-and-forth type interactions of litigation and quicker toward a solution. This focus on commercial interests, rather than legal positions, allows the process to move along quicker, resulting in lower fees for clients, making mediation a more viable option for obtaining dispute resolution on a lower budget than the legal system allows for.

By focusing on the proportionality and transparency of costs, the Jackson reforms take huge steps in making the UK civil justice system available to all of those who wish to take advantage of it. But given Lord Jackson's talk at Middle Temple, confirming his belief that ADR and mediation, based on his own research on a worldwide level, is "the single most important way to cut costs", should the reforms perhaps have gone further to promote the use of ADR and mediation?



Lord Jackson's closing remarks reminded those present – predominantly lawyers – that the responsibility of the legal system was to represent the interests of clients and to help them to get access to justice, rather than to serve its own needs. Our experience suggests that more clients are beginning to take this into their own hands by referring cases for mediation directly to CEDR rather than involving their external legal advisers or the courts – perhaps this will be the dynamic that will put mediation higher up the agenda for any future reforms. CD

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PERSPECTIVES

SMALL BUSINESS PROBLEMS, ADR SOLUTIONS

BY **KEISHA WILLIAMS**
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Small businesses are the backbone of our economy. The UK Department for Business, Innovation & Skills reports that, at the start of 2015, small businesses accounted for 99.3 percent of all private sector businesses in the UK and 48 percent of private sector employment. Small and medium sized enterprises (SMEs) together generate a combined annual turnover of £1.8 trillion. As with many businesses, when legal problems arise, SMEs often seek recourse in the court system. However, the conventional adversarial approach to justice is no longer sustainable due to the rising cost of litigating. Earlier this year, significant court fee increases took effect, hiking the cost of commencing proceedings by up to 600 percent in some cases. The Ministry of Justice has since announced that further increases are being mooted. In the midst of the fallout, a light is being shone on ADR once more, not just as a sound, cost-effective option to resolve commercial disputes, but critically as a means of providing access to justice for SMEs priced out of the court system.

Two tier justice

Civil court fees for claims between £10,000 and £200,000 increased dramatically in March 2015, to 5 percent of the sum claimed, with a maximum fee set at £10,000. For a claim of £150,000 the increase meant a rise in the upfront cost of bringing proceedings, from £1315, to £7500 (5 percent of

the claim value). Barely had the dust settled when the Ministry of Justice announced a new round of consultation on further proposed increases, which would see the maximum fee for money claims rise from £10,000 to £20,000, or a removal of the cap completely.

The Ministry of Justice contends that the increases are necessary to shift the cost of running the courts from the taxpayer to court users themselves, and to redress the imbalance of a court service which costs £1bn a year more to run than it receives in income. This strategy could, however, be counterproductive if demand for the court service lessens as a result. For international commercial litigants who forum shop, a decrease in the competitiveness of the UK's legal system could see them take their cases to cheaper jurisdictions, negating the UK's standing as a leading centre for commercial dispute resolution. However, for UK based individuals and small businesses, the impact of court fee increases is, arguably, particularly disproportionate. Many small businesses engage in court action to recover unpaid monies. It is estimated that small firms are owed over £32bn in late payments. Critics argue that not only will SMEs be reluctant to pursue legitimate debt claims, thereby undermining the rule of law, but there will be an imbalance in the bargaining power of SMEs in settlement discussions with larger firms, which will feel incentivised to deny liability, safe in the knowledge that their opponent could not afford to bring proceedings. The Bar Council and the Law Society in particular have voiced concerns that the increased court fees will exacerbate small business insolvency, and stifle the cash flow of vulnerable businesses. Alistair MacDonald QC, Bar Council chairman, said: "Cash-flow is the life blood of small businesses and many end up having to pursue late payments and other debts through the court system. Imposing a 5 percent fee may well make many small businesses think twice before making that claim, and will certainly strengthen the hand of late payers."

The shift to ADR

Alternative dispute resolution (ADR) has, for some time now, been gaining traction with the business community as a viable means of resolving commercial disputes away from the courts. Simply defined, ADR describes a range of procedures and techniques which provide a means of resolving a dispute without court intervention, usually with the help of a third party neutral. In addition to ADR often being a comparatively quicker and cheaper process than court litigation, businesses cite the confidentiality of the process, and the ability to preserve business relationships, as key drivers in their decision to shift to ADR mechanisms.

However, ADR is not yet on everyone's radar. Alarmingly, a recent survey by IPSE, the Association of Independent Professionals and the Self Employed, found that only 5.5 percent of their members were aware of ADR. Those that are aware often find the ADR landscape confusing and difficult to navigate.

In November 2015, the Ministry of Justice also published the results of a court users' survey for 2014/15, which showed that only 23 percent of claimants had entered formal mediation, with 43 percent disregarding it as an option. The challenge, then, is not just raising the profile of ADR among the SME community, but also empowering SMEs to make informed decisions as to which method of ADR is most appropriate for their dispute. ADR institutions must play a greater role in information sharing, but so too must the legal profession. Recently elected Conservative MP Alberto Costa, a former City Solicitor, noted at a recent fringe event that some of his ex-colleagues are still not doing enough to encourage and promote ADR: "Looking back over the last 15 years we are not where ADR

was promised to be. Most business people don't know what ADR stands for," said Mr Costa. "The majority of litigators, particularly in the City, are still not qualified [in ADR]. People are still wedded to the court system." Mr Costa also submitted that ADR clauses should become standard in contracts drawn up by lawyers for their clients.

In an effort to entice SMEs into the ADR market, several institutions offer bespoke ADR procedures aimed at small business disputes or disputes of low to medium monetary value. The London Maritime Arbitrators Association (LMAA) Small Claims Procedure and the Chartered Institute of Arbitrators (CIArb) Business Arbitration Scheme are two such examples. In 2012, HMRC launched an ADR service for SMEs, and the Ministry of Justice has recently made permanent a pilot mediation scheme for small claims, assisting users with finding a mediator to mediate the dispute for a fixed fee, for claims up to a value of £50,000.

"In an effort to entice SMEs into the ADR market, several institutions offer bespoke ADR procedures aimed at small business disputes or disputes of low to medium monetary value."

Small Business Commissioner

The government is acutely aware of the importance of SMEs to the economy, and the difficulties facing small businesses in particular. So much so that the Enterprise Bill currently passing through Parliament, which is concerned with the promotion of enterprise and economic growth, provides the legislative framework for the creation of a Small Business Commissioner. It is envisaged that the Commissioner will have a complaints handling function, *vis-à-vis* complaints from small business suppliers about payment issues they are facing with larger firms, and will have discretion to 'name and shame'. The Commissioner will also provide advice and information to small businesses involved in disputes, but would not, as many had hoped, act in the capacity of dispute resolver, like the Advisory, Conciliation and Arbitration Service (ACAS) does in employment relationships, or have any enforcement powers. Instead, it will 'signpost' small businesses to appropriate third party service providers, which may include sector ombudsmen or regulators, existing independent advice services, and established ADR providers. Small Business Commissioners are

already established in some jurisdictions, such as Australia, where, as well as referring businesses to dispute resolution services, the advisory services range from tax advice, to advice on how to start, grow and exit a small business. The establishment of a Small Business Commissioner in the UK signals a strong commitment to building the confidence and capabilities of small businesses in the negotiation process with suppliers and in the exercise of their legal rights when disputes arise, and could, over time, counteract any damage being caused by prohibitive court fees. It also further exemplifies the government's shift toward actively promoting dispute avoidance and management through ADR mediums, which is not just in the government's interest as it grapples with a climate of fiscal constraint, but is good news for the business community in general. CD

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ONE-ON-ONE-INTERVIEW

DISPUTE RESOLUTION IN TURKEY

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Orçun's Cetinkaya's work includes all aspects of disputes, corporate and employment law matters. He regularly supports both local and foreign clients during cross-border disputes and debts, often involving high values or complex liability issues. Mr Çetinkaya advises clients on a broad range of issues including contractual claims, shareholder and partnership issues, joint ventures, construction, real estate, agency, professional negligence and employment matters, as well as administrative issues, tax disputes, customs, international trade and business crimes. During his career, Mr Çetinkaya has advised and represented clients at all types and levels of dispute resolution forum in Turkey, from local ad hoc tribunals through to supreme courts.

CD: Could you provide an overview of the current dispute resolution landscape in Turkey? How would you describe the infrastructure and processes in place to support dispute resolution?

Çetinkaya: Commercial disputes are on the rise in Turkey due to recent economic instability arising from local and regional political fragility. The Turkish lira weakening against the US dollar and euro should have fuelled exports; however, regional instability hindered exports by Turkish companies. Therefore, manufacturers relying on local sales and regional exports have suffered as they could not turn their products into cash. As a result, they could not make payments to their suppliers during recent months, giving rise to lawsuits, collection proceedings and applications to delay or execute bankruptcies. While it was hoped that the recent elections would end economic volatility, it seems the recent political crisis between Turkey and Russia will add another problematic dimension to cross-border deals and transactions. Potential exists for commercial cases and commercial or treaty arbitrations to arise, given that Turkish companies in Russia are now receiving hostile treatment, several Russian state-supported projects have been are suspended and Russia has imposed sanctions over certain goods exported from Turkey. Commercial disputes are heard by commercial courts which are in all major cities where disputes above certain amount are handled by a council composed of three judges. Commercial court judges are appointed from among the most senior judges, having considerable experience. Although expert opinions are a decisive factor in commercial cases, the manner in which commercial courts approach disputes in Turkey has a settled method and reliability, compared to other developing countries. Particularly, commercial court judges in cities such as Istanbul, Ankara, Izmir, Bursa and Adana are quite experienced, having heard thousands of different commercial conflicts. I believe the Achilles' heel of Turkish commercial dispute resolution mechanisms is the lack of specialised courts. Specialised courts do exist in Turkey, such as IP courts. However, the degree of specialism and the immeasurable variety of commercial transactions seem to require more specialised courts than currently exist. Personally, I would prefer to take my cases to a court specialised in construction in Istanbul, similar to the Technology and Construction Court in London, as opposed to ad hoc arbitrations. The lack of specialism among commercial judges places increased significance on court appointed experts in commercial courts; the more complex the case, the more judges rely on experts. There are methods to tackle this problem, but it is an ongoing issue with Turkish commercial dispute resolution, as far as I am concerned. On the other hand, use of injunctions is quite important given that commercial cases can take between one and three years under normal circumstances. If an

injunction is not obtained, it may not matter whether or not the case is won, since the defendant could dissipate the assets during the proceedings. There is no mechanism that would deter parties from dissipating assets during a case, such as monetary penalties, criminal consequence or debarment. Thus, the need for injunction is highlighted, along with the consequences of this not existing. Generally, courts request collateral equal to 15 percent of the subject asset's value. However, I have seen examples where the courts did not ask for collateral at all, or asked for collateral equal to just 1 percent.

CD: How prevalent is the use of alternative dispute resolution in Turkey? How might this approach be more beneficial than proceeding directly to litigation?

Çetinkaya: For a variety of reasons, domestic arbitration institutions are not preferred. These reasons include costs, as well as a lack of awareness and general arbitral culture in Turkey. Several arbitration institutions operated by chambers of commerce have a little market share in Turkey. In the absence of reliable arbitral institutions, ad hoc arbitrations composing academic arbitrators have been more attractive to parties. However, the lack of arbitrators' industry expertise, secretariat and pace are heavily criticised. As in the case of commercial courts, local arbitral panels rely heavily on expert opinions, which, in turn, give rise to questions of efficiency. In my experience, although panels at local arbitrations are more flexible in selecting experts, the way experts can impact cases has almost no difference to court proceedings. Besides, arbitrator fees are extremely high in local ad hoc proceedings, despite their slow pace and questionable expertise. Accordingly, parties are prompted to think twice before going for arbitration instead of courts. With these concerns in mind, a new arbitral centre was recently established in Turkey, named the Istanbul Arbitration Centre. The new forum is intended to provide the necessary expertise, impartiality and independence, as well as to promote a culture and use of arbitration in Turkey, along with other alternative dispute resolution methods. The Centre recently declared its fee structure, under which it seems arbitrations will be resolved for fees equalling no more than 10 percent of court fees.

CD: In your opinion, what are the strengths and weaknesses of Turkey as seat a for arbitration proceedings?

Çetinkaya: Turkey should be seen as an appropriate arbitral seat for all foreign and domestic parties. Particularly, Istanbul has huge potential, given that it is a centre which ties not only continents, but also cultures and history. Turkey is unique in a geographic sense because Istanbul can be reached by 50 percent of the

world's population within four hours. Although the International Chamber of Commerce in Paris or the London Court of International Arbitration Centre are regularly selected as institutions, due to visa problems for non-European parties, it is increasingly common to have trials in Turkey. International or regional trade and business in sectors such as construction, transport and energy has one way or another relation with either Turkish parties or Turkey which also puts Turkey in a position to be good seat for international arbitrations. Consequently, Istanbul has a higher chance to be an international arbitration seat rather than being an arbitration centre in the region, at least in the short term. Having said that, if Istanbul becomes a preferred seat for international arbitration, the Istanbul Arbitration Center will follow this lead and gain momentum compared to other international arbitration institutions.

CD: What advice would you give to parties looking to commence arbitration proceedings in Turkey? How should a company go about developing an effective strategy?

Çetinkaya: While it firmly depends on the sector in which parties operate, I would recommend that arbitration or court proceedings should be considered as a last resort, given enforcement related problems. If possible, it is advisable to enter a negotiation and then mediation phase, prior to embarking on arbitration, even if it these stages are not procedurally required. In fact, surprisingly, a large number of Turkish companies are not litigious at all, particularly those which are above SME size. They do business in Turkey or abroad

"While it firmly depends on the sector in which parties operate, I would recommend that arbitration or court proceedings should be considered as a last resort, given enforcement related problems."

Orçun Çetinkaya, Moroglu Arseven

with commercial parties or sovereigns and tend to solve their problems amicably if this is possible. The construction industry is a trendsetter in terms of dispute management and avoidance, achieved through dispute avoidance and dispute review boards. Involving experts in contracts long before disputes arise contributes massively to developing a manageable and sustainable relationship. However, if disputes are inevitable, the way in which parties kept their records will be quite decisive, irrespective

of whether they engage in institutional or *ad hoc* arbitration. If the rules of Turkish Civil Procedural Law are followed during arbitrations in Turkey, written evidence submitted by the parties will play a crucial role. Equally, parties should carefully select their arbitrators. Academics without any commercial tenure, or without a practitioner's experience or knowledge about commercial arbitration, can slow down the process, as well as make unpredictable procedural or substantive decisions. As indicated above, experts dominate arbitration proceedings. Accordingly, parties should be aware of this and should also pay close attention during appointment of experts.

CD: To what extent is the autonomy of the arbitral process fully recognised in Turkey? What, in your opinion, are the benefits and drawbacks of such self-determination?

Çetinkaya: Pursuant to Article 424 of Turkish Civil Procedural Code numbered 6100, parties are entitled to determine procedural rules for arbitrators to apply in the course of arbitration proceedings, provided the rules do not contradict mandatory aspects of the Code. Arbitral awards can be cancelled by state courts. Therefore, the autonomous character of parties seeking recourse to arbitration can be interfered with on the basis that the arbitrated decision is against public order. We believe that complete autonomy is necessary for arbitration proceedings to reflect parties' true intentions.

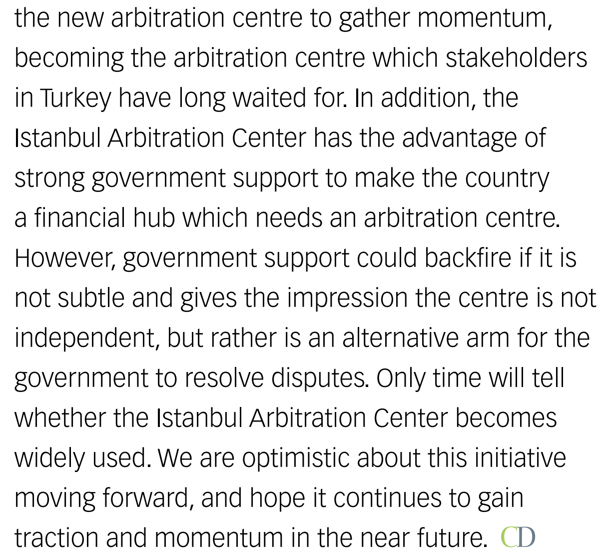
CD: Do any particular challenges or issues exist in terms of enforcing arbitral awards in Turkey? How are foreign arbitral awards dealt with in light of the UNCITRAL Model Law and the New York Convention, for example?

Çetinkaya: In accordance with the New York Convention, to recognise a foreign arbitral award in Turkey, the arbitral decision must not contradict the Turkish public order. However, Turkish judges are particularly interested in this public order exception as a method to review the merits of arbitral decisions. Turkish judges continue to find reasons to set aside arbitral awards. Nevertheless, commercial courts in big cities such as Istanbul and Ankara have a more reasonable approach. It is a relief that courts in other cities have started to be influenced by this approach. Another challenge is that no special chamber of the Turkish Supreme Court exists to review set-aside applications. Therefore, there is no uniform approach on which parties can rely when enforcing their awards.

CD: What future developments and trends do you expect to see in dispute resolution in Turkey over the years ahead? Does Turkey have the capacity

to become an arbitration hub to rival more established European seats such as London, Paris and Geneva?

Çetinkaya: The Istanbul Arbitration Center was recently established and has been drawing much attention. It has been widely discussed that a new approach to adjudication of commercial disputes is urgently needed in Turkey. Turkish lawyers, parties, judges and expert witnesses have all become frustrated by the way commercial disputes are handled in Turkey by state courts, ad hoc arbitral bodies and local arbitration institutions. Such frustration could present an opportunity for



the new arbitration centre to gather momentum, becoming the arbitration centre which stakeholders in Turkey have long waited for. In addition, the Istanbul Arbitration Center has the advantage of strong government support to make the country a financial hub which needs an arbitration centre. However, government support could backfire if it is not subtle and gives the impression the centre is not independent, but rather is an alternative arm for the government to resolve disputes. Only time will tell whether the Istanbul Arbitration Center becomes widely used. We are optimistic about this initiative moving forward, and hope it continues to gain traction and momentum in the near future. CD

PERSPECTIVES

THE TAX MAN COMETH – IRS EXPANSION OF SECTION 482 TRANSFER PRICING ENFORCEMENT TO MIDDLE-MARKET COMPANIES

BY **STEVEN TOSCHER AND LACEY STRACHAN**
> HOCHMAN, SALKIN, RETTIG, TOSCHER & PEREZ, P.C

In the past, transfer pricing cases have typically been large transactions involving large corporations – often the sales of goods and services between US companies and their foreign affiliates. But the landscape of transfer pricing cases is changing. The globalisation of the world economies has substantially increased the number and size of the companies engaged in cross-border transactions, making transfer pricing much more relevant to all corporations and their professionals.

In the past couple of years, the IRS has been shifting more resources to training specialised transfer pricing examiners and teaching examiners to recognise controlled transactions that may present a transfer pricing issue. The Large Business & International (LB&I) division of the IRS has established a team of transfer pricing specialists,

who released a Transfer Pricing Audit Roadmap in 2014 that was designed to provide examiners with audit techniques to assist with transfer pricing examinations.

With the increased scrutiny by the IRS, now is the time for all corporations that engage in transactions with foreign controlled entities to make sure they have a transfer pricing policy and supporting documentation in place to ensure that the transfer prices are set at arm's length.

What is transfer pricing?

Transfer pricing refers generally to the setting of prices for property and services sold between controlled entities, such as a parent corporation selling goods to a subsidiary. Where those corporations are in different tax rate jurisdictions,

the IRS wants to ensure that the income associated with such transactions reflects the economic reality of the transaction.

Section 482 of the Internal Revenue Code is designed to prevent income-shifting through controlled transactions, by allowing the IRS to adjust the amount charged in related-party transactions (where two or more businesses are owned or controlled directly or indirectly by the same interests), for purposes of determining a related party's taxable income if the amount charged is determined to not be 'arm's length'. Under the regulations, a transaction meets the arm's length standard if "the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances". The regulations set forth extensive guidelines on the methods to be used to determine the arm's length range for a transaction, in order to place "a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer".

Transfer pricing examinations

The Audit Roadmap sets forth a two-year timeline for transfer pricing examinations, including the initial planning stage. The roadmap places great emphasis on the planning stage, during which examiners will review a taxpayer's tax and information returns to identify controlled transactions and to compute financial ratios that the examiner will use to help determine potential non-arm's length transfer pricing issues. Examiners will also research the background,

"The IRS advises examiners that transfer pricing cases are usually won and lost on the facts."

history, and core business operations of the taxpayer, to try and gain an understanding of the relationship between the taxpayer and its foreign affiliates and the role each entity plays in carrying out the group's activities.

The IRS advises examiners that transfer pricing cases are usually won and lost on the facts. Examiners are advised to put together a compelling story of what drives the taxpayer's financial success, based on a thorough analysis of functions, assets and risks, and an accurate understanding of the relevant financial information. If indications are that the tax result claimed by the taxpayer is at odds with

common sense and economic reality – 'too good to be true' – the IRS recommends further scrutiny. If instead the examiner finds the taxpayer's financial results to be reasonable in light of all of the facts, that may cause the IRS to choose not to pursue the issue.

Potential penalties

If a transfer pricing examination results in an adjustment, the adjustment may be subject to a substantial (or gross) valuation misstatement. A 20 percent substantial valuation misstatement penalty is triggered in transfer pricing cases in two situations: (i) where the price for any property or services subject to Section 482 is 200 percent or more (or 50 percent or less) of the arm's length amount; or (ii) if the net Section 482 transfer price adjustment exceeds the lesser of $5m or 10 percent of the taxpayer's gross receipts. While the reasonable cause exception under Section 6664(c) generally applies to substantial valuation misstatement penalties, it does not apply to the second situation – a penalty triggered by a net Section 482 transfer price adjustment. Instead, the penalty can be avoided only if certain documentation requirements are satisfied.

To avoid a substantial valuation misstatement penalty triggered by a net Section 482 transfer price adjustment, three conditions must be satisfied: (i) the taxpayer determined the price in accordance with a specific pricing method allowed under the regulations and use of that method was reasonable (or, the taxpayer used another pricing method that was likely to result in a price that would clearly reflect income, if the pricing methods in the regulation would not be reasonable); (ii) the taxpayer has documentation that was in existence at the time of filing the return setting forth the determination of the price and establishing that the use of the method was reasonable; and (iii) the taxpayer provides such documentation to the IRS within 30 days of a request – which will happen at the outset of each transfer pricing audit.

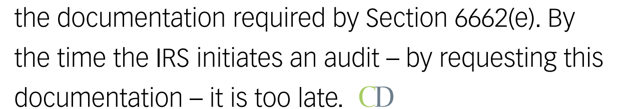
Developing a transfer pricing policy

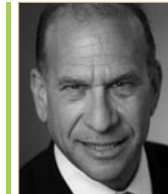
Obtaining a transfer pricing study with contemporaneous documentation is critical to avoiding penalties and may help to avoid a lengthy audit. The documentation should accurately and completely describe the basic transfer pricing analysis that was conducted and must include: (i) an overview of the taxpayer's business; (ii) a description of the taxpayer's organisational structure covering all related parties engaged in controlled transactions; (iii) an explanation of the transfer pricing methods considered and how the method chosen was selected; (iv) a description of the controlled transactions; (v) an explanation of the comparables used and how comparability was evaluated; (vi) an explanation of the economic analysis and projections; (vii) a description of any relevant data obtained between the end of the year and the filing

of the tax return; and (viii) a general index of the documents.

Conclusion

While the Audit Roadmap was developed by the IRS for use by examiners, it is relevant to all taxpayers with transactions with controlled affiliates, because we know where the roadmap will lead – and that is to more examination activity of more and more taxpayers, not just large companies. The best way for taxpayers to prepare for a transfer pricing audit is before the taxpayer's return is filed and ideally before the transactions are even entered into – by obtaining a transfer pricing study that determines an arm's length price and maintaining


the documentation required by Section 6662(e). By the time the IRS initiates an audit – by requesting this documentation – it is too late. CD



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PERSPECTIVES

REPATRIATION OF FROZEN DIVIDENDS OF FOREIGN COMPANIES IN VENEZUELA

BY **BY BERNARDO M. CREMADES, JR.**
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In recent months, some major Spanish newspapers have reported that the subsidiaries of Spanish companies operating in Venezuela have accumulated exposures of at least €8bn. One of the main problems faced by Spanish companies in Venezuela is the exchange control policy of the Venezuelan government. Today in Venezuela there are three rates of exchange of the national currency (the Bolivar) against the US dollar. According to press reports, because of Venezuela's foreign exchange control policy, Iberia has retained over €184m from ticket sales which it cannot repatriate to Spain because it cannot gain access to an appropriate exchange rate. Meanwhile, it is estimated that Air Europa has profits of at least 85m and BBVA has $500m in accumulated dividends in Venezuela which they cannot repatriate to Spain. Furthermore, it was reported as a relevant fact to the Spanish stock exchange that Venezuela's monetary policy caused a drop of €399m in Telefonica's net profit in 2014. Some of the other 110 Spanish companies operating in Venezuela that could experience similar problems are Repsol, Mapfre, Meliá or Duro Felguera. Although there are no specific statistics available, foreign investors from other countries may also be in the same position.

Solution under Bilateral Investment Treaties

States frequently sign international treaties in order to encourage and promote reciprocal investments between both countries (commonly known as Bilateral Investment Treaties or BITs). Such treaties usually include substantive protections for foreign investors, including clauses providing for fair and equitable treatment, full protection and security, compensation for expropriation, etc. Of particular relevance are the provisions in many BITs allowing the repatriation of the investment and any returns arising from such investment to the country of origin.

Spain and Venezuela signed an international treaty to this effect on 2 November 1995, which is currently in force. Article VII of the BIT between Spain and Venezuela provides that the state receiving the investment – in our case, Venezuela – "shall guarantee" the Spanish investors *inter alia* "the unrestricted transfer of payments related to" their investments in Venezuela including the "investment returns", which are "amounts yielded by an investment" and include "includes profit, dividends, interest, capital gains and royalties", the "proceeds of the sale or liquidation of all or part of the investments", and the "wages, salaries and other remuneration received" by non-nationals of Venezuela working in such territory for the foreign investor in a capacity of "directors, advisors, technicians or specialised workers".

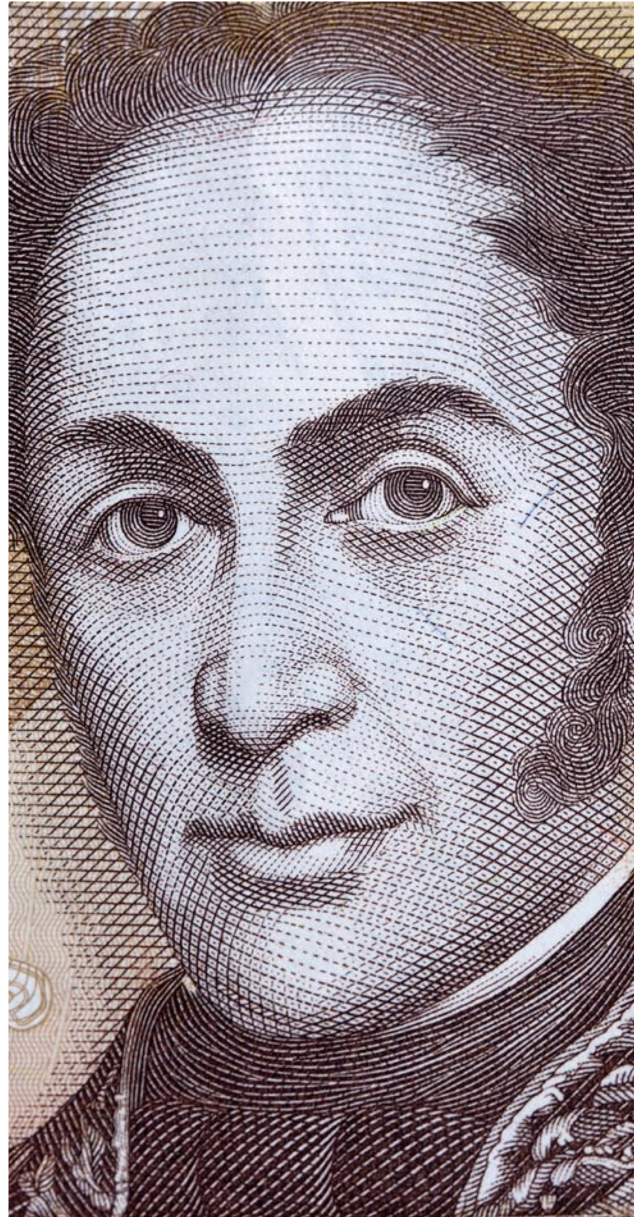
The next paragraph of this Article states that Venezuela "shall guarantee the [Spanish] investor, on a non-discriminatory basis, the possibility of acquiring the necessary foreign currency to make the transfers covered by this Article". The key is the term "non-discriminatory", because if the exchange rate policy is general and applicable to all Venezuelans and other international investors, Venezuela may not be violating the BIT by failing to authorise the Spanish companies to acquire the currencies necessary to repatriate their investments and returns. However, the last paragraph of Article VII of the BIT between Spain and Venezuela contains a most-favoured nation clause, which provides that, if Venezuela accords a more favourable treatment to investors of any third state (e.g., Argentinean investors) for the repatriation of investments and

"The BIT between Argentina and Venezuela, signed on 16 November 1993, contains a provision on the repatriation of investments and returns that is much more favourable than the correlative of the Spain-Venezuela and Barbados-Venezuela BITs."

returns, then it must also grant such treatment to Spanish investors.

The same is true under other BITs signed by Venezuela. For instance, after the termination of the Venezuela-Netherlands BIT, many foreign investors migrated their tax structures relating to their investments in Venezuela from Dutch companies to Barbadian companies. The Barbados-Venezuela BIT of 1994 remains in force and Article 6 thereof provides that Venezuela shall "guarantee to nationals or companies of [Barbados] the unrestricted transfer of their investments and returns". And adds that "[t]ransfers shall be effected without delay in the convertible currency in which the capital was originally invested or in any other convertible currency agreed by the investor and [Venezuela]". Like other BITs signed by Venezuela, "returns" is to be interpreted broadly and "means the amounts yielded by an investment and in particular, though not exclusively, includes profit, interest, capital gains, dividends, royalties and fees". Furthermore, Article III of the Barbados-Venezuela BIT contains a most-favoured-nation provision that specifically applies to "investments" and "returns" of Barbadian investors, and clarifies that such provision applies to the repatriation of investments and returns under Article six of the BIT.

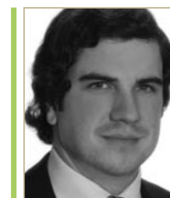
The BIT between Argentina and Venezuela, signed on 16 November 1993, contains a provision on the repatriation of investments and returns that is much more favourable than the correlative of the Spain-



Venezuela and Barbados-Venezuela BITs. In this regard, Article 5 of the BIT between Argentina and Venezuela provides that the latter "shall accord to [Argentinian] investors the unrestricted transfer of investments and returns", including but not limited to "benefits, profits, interests, dividends and other ordinary income", "the proceeds of the sale or total or partial liquidation of an investment", and the "income" of Argentinian workers in Venezuela. The important and much more favourable part appears in the second paragraph of Article V, which states that the "transfers shall be effected without delay, in freely convertible currency at the normal applicable exchange rate at the date of the transfer, in accordance with the procedures established by [Venezuela], which may not affect the substance of the rights provided in this Article". In other words, under this provision Venezuela may not impose currency constraints on the repatriation of investments and dividends by Argentinean nationals. Consequently, in accordance with the most favoured nation clause of the Spain-Venezuela and Barbados-Venezuela BITs, foreign investors from such countries may have a sufficient basis to initiate arbitration against Venezuela to obtain relief.

Dispute resolution under the BITs

Both Article XI of the Spain-Venezuela BIT and Article 8 of the Barbados-Venezuela BIT provide for international arbitration. In this regard, after Venezuela's withdrawal from the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature in Washington on 18 March 1965 (commonly known as the ICSID Convention), it remains debatable whether a foreign investor may pursue international arbitration against Venezuela under the ICSID Convention or may only submit the dispute to the International Centre for Settlement of Investment disputes under the Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the Centre (Additional Facility Rules) when such a mechanism is also provided for in the relevant BIT. This is precisely the situation under both the Spain-Venezuela BIT and Barbados-Venezuela BITs. In some cases, under these treaties the foreign investor may alternatively submit the dispute to an *ad hoc* arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). The arbitral tribunal may fix the amount of compensation payable by Venezuela to the foreign investor and the arbitral awards are final and binding on the parties in dispute. CD



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PERSPECTIVES

PROTECTING THE CROWN JEWELS: THE USE OF RESTRICTIVE COVENANTS AND CONFIDENTIAL INFORMATION PROVISIONS GLOBALLY

BY **MATTHEW HOWSE AND SARAH STOCK**
> MORGAN LEWIS

As globalisation and employee mobility continue to increase, we are frequently asked by employers whether a non-compete or other restrictive covenants (such as a covenant against the non-solicitation of customers or employees) is enforceable in a particular jurisdiction.

The issue arises in a variety of contexts, including when a company is considering hiring a candidate whose employment contract includes restrictive covenants, whether to include restrictive covenants in an executive employment contract or other employment agreement (such as a share or bonus plan) and, increasingly as the economic situation improves, whether a non-compete or other restrictive covenant can be enforced against a departing employee. As the war for talent increases, many employers understandably wish to protect themselves against the risk that their employees

will – after building valuable relationships with customers or having access to the employer's confidential information and intellectual property – go to work for a competitor.

The first step for many employers is to ensure that employees are not tempted to leave by keeping them motivated and appropriately remunerated. In addition, however, most employers will also adopt defensive measures – such as contractual confidentiality provisions and restrictive covenants – to protect their business.

A global form of restrictive covenant?

Multinational employers like to have documents and policies that are consistent and similar in all of the countries where they operate so as to reduce the administrative burden and to foster a common culture and approach. Accordingly, such employers are often tempted to roll-out globally the form of restrictive covenant and confidential information provisions that are used in the 'home' jurisdiction. While such an approach meets the desired aim of consistency and can have a deterrent effect on employees, such an approach is very risky from an enforcement perspective.

The reason for this is that the enforceability of restrictive covenants usually depends on the law of the jurisdiction where the employee works. Restrictive covenant enforceability standards vary widely from country to country, as every jurisdiction seeks to balance the competing interests of an employee's right to work and an employer's right to protect its business interests. With each jurisdiction balancing these interests in its own particular way, a multinational employer has to accept that a 'global' non-compete will be unenforceable in many jurisdictions as it will encounter a wide variation of restrictive covenant enforceability standards across its worldwide operations.

Accordingly, the best approach for an employer that wishes to impose restrictive covenants that are likely to be enforceable on its employees is to have carefully drafted restrictions for each separate jurisdiction. Because enforceability rules differ markedly across jurisdictions, standard restrictive covenant provisions that are perfectly appropriate for one place will not necessarily be enforceable even within a geographical region.

Common threads

That said, there are common themes across jurisdictions and regions. In most countries, an employer looking to enforce restrictive covenants will need to show that they are seeking to protect legitimate business interests such as customers, employees and confidential information. Similarly, the duration of the restriction is an important consideration, although what is considered reasonable and therefore permissible varies widely from jurisdiction to jurisdiction. Another important factor is whether payment is required for duration of restriction.

A multinational employer should start by analysing whether the proposed restriction is enforceable at all in the relevant jurisdiction. For example, in a number of jurisdictions, non-competes in an employment context are void. As a general principle, even in jurisdictions where non-competes are permissible, the courts will more readily enforce non-solicitation of customers covenant than a pure non-compete. Even if a particular type of restriction is capable of being enforceable in a certain jurisdiction, it is important to ensure that it is tailored to the relevant type of business or industry and to the type of employee. In very few, if any, jurisdictions will one form of restrictive covenant be suitable for all employees. A restrictive covenant suitable for an executive is unlikely to be enforceable against a more junior employee.

Garden leave as an alternative?

Some employers are looking to use a technique that has become common in the UK to sidestep restrictive covenant enforceability barriers.

Restrictive covenants are designed to apply after the employee's employment has terminated. The technique – known as 'garden leave' – effectively converts post-termination restrictions into 'during-employment' restrictions. This involves keeping the employee employed and continuing to provide pay and benefits from but excusing the employee from their work duties and responsibilities for the proscribed period which thereby allows the employee time to spend in his garden. As the employee remains employed, the employer can forbid them from competing, soliciting or contacting customers and fellow employees and stop their access to confidential information.

In the UK and some other countries which have notice periods in the employment contract, the garden leave period equates to the employee's notice period. In the US, it is a period equivalent to the non-compete period after what would otherwise have been the employee's separation date. The theory behind garden leave is that the courts in many jurisdictions look more favourably on restrictions during employment than after and that garden leave therefore simplifies restrictive covenant enforcement. The clear downside, however, is that it is expensive – the employer has to continue to provide salary and benefits for the garden leave period but gets no work in return.

A quick world tour

As we discuss above, the law on restrictive covenants varies from country to country but it is possible to highlight in very broad terms the key issues in various regions.

> "It is clear that restrictive covenants are a vital tool for multinational employers in a world where employee mobility gathers pace."

Europe. In most European jurisdictions, restrictive covenants are considered to be a restraint of trade unless they are considered reasonable in the circumstances. To assess reasonableness, a four-stage test is usually applied and a restrictive covenant will only be enforceable if it is: (i) limited in geographic scope; (ii) limited in duration although the permissible duration varies from country to country; (iii) seeks to protect a legitimate business interest such as confidential information or customer connection; and (iv) ongoing compensation is paid during the restricted period. The amount of compensation required, however, varies among

countries and is not necessary at all in the UK or Switzerland.

Asia. In most Asian countries, post-termination restrictions are typically enforceable provided they are reasonable. The reasonableness considerations are similar to those applied in Europe. Ongoing compensation during the restricted period is typically not required in most Asian countries although compensation of between 20-60 percent of the employee's salary is required in most Chinese provinces. What is considered a reasonable duration for a restrictive covenant varies so that, for example, in Singapore a restricted period of one year may be enforceable but only three months would be considered reasonable in Hong Kong.

Latin America. In Latin America, there are wide differences in approach to restrictive covenants from country to country. For example, non-compete covenants are likely to be enforceable in Argentina, Peru and Venezuela if they are restricted in time and the employee receives reasonable consideration for temporarily waiving his or constitutional right to work but are void in Mexico, Chile and Colombia. Although non-competition and non-solicitation covenants are becoming more common in Brazil, they are not regulated expressly by the Labor Law. Brazilian case law has held that non-compete clauses can be valid for up to 24 months provided that the employee is reasonably indemnified (at least 50 percent of the last monthly salary) for the non-compete period.

Middle East. In Saudi Arabia, restrictive covenants (including non-competes) are enforceable up to two years in duration and there is no need for payment of compensation. In the UAE injunctive relief is unobtainable from UAE courts, so restrictive covenants are of little use, although it is possible to use Ministry of Labour administrative processes to prevent an employee from working. If the business operates in the DIFC or other free zones, restrictive covenants can be enforced in the DIFC and other free zone courts.

United States. The law on restrictive covenants is a matter of state, not federal, law. Restrictive covenants are liberally enforced in some states but are considered void in some other states such as California. Most states recognise as valid and will enforce a covenant not to compete, solicit or deal, provided that the covenant is: (i) supported by adequate consideration; (ii) necessary to protect a legitimate business interest such as trade secrets or customer connection; and (iii) reasonable in time, subject matter and geography. There is generally no requirement to pay an employee while they are subject to a restrictive covenant.

Conclusion

It is clear that restrictive covenants are a vital tool for multinational employers in a world where employee mobility gathers pace. But an employer seeking to draft enforceable restrictive covenants across national boundaries will have to be willing

to accept that this is an area of law which does not allow for a common approach. The large variation among jurisdictions regarding the enforceability of restrictive covenants means that a multinational employer will confront a wide variety of restrictive covenant enforceability standards. The most practical strategy is to draft restrictive covenants to conform to the various jurisdictions in which it operates. The employer should focus on where its employees are actually working as this is where it will likely want to be enforcing the restrictive covenants. CD

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MINI-ROUNDTABLE

CYBER SECURITY AND EMPLOYEE RISKS

PANEL EXPERTS

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CD: To what extent are you seeing a rise in cyber related employee theft? Are today's companies at greater risk of discovering their electronic data has been copied or stolen?

Coyne: Employee theft has ballooned in the last year in particular. This is likely to be due to a number of technical and commercial factors. Perhaps the biggest technical factor is the rise of cloud-based management systems which allow users to access data from anywhere provided they have the correct credentials. Partner this with the fact that essentially everyone is now connected to the internet via their mobile devices, and it is easy to see how a soon-to-be ex-employee could procure sensitive information for later use. It takes very little technical ability to access information in this way, and it is very difficult for firms to effectively protect against since the theft is being carried out by a 'trusted' source.

Sykes: Employee knowledge of forensic tools available to track down their misdemeanours is definitely lagging behind capabilities, and with mobile devices being the single highest means of stealing company data, ex-employees feel safe seemingly because they have the phone and we don't. But in many cases locational data absolutely identifies the means by which company IP and data has been stolen. Combining this with more traditional cell site analysis and forensic data recovery and there are few opportunities to be assured of anonymity.

CD: In your experience, are malicious employees – who may be looking to harm a company or profit dishonestly from it – growing savvier about the value of business data they routinely handle, and the impact of its loss to a business?

"Employee theft has ballooned in the last year in particular. This is likely to be due to a number of technical and commercial factors."

Jason Coyne,
IT Group UK Ltd

Sykes: In my opinion, knowledge and awareness is definitely lagging behind the capabilities to track and identify but there is definitely a greater understanding with regard to backups and recovery options. A recent example involved tracking down and proving the perpetrator of a deletion, not only

of the entire company's database, but all its backups in a data centre in London and its secondary cloud backups. While this was eventually done and most of the data was restored, the cost in real terms was significant, and while the police did a thorough and professional job, it was difficult at times to get the commitment from them because the view was, and possibly quite justified, that no one was attacked, no one was killed – it was just data.

Coyne: I don't know whether or not such employees are growing savvier about the business impact of their actions, but they certainly seem to be growing savvier in terms of understanding the ease with which they can exploit cloud-based systems which are not tightly regulated. In a recent case an employee had attempted to sell his employer's computer source code on one of the popular internet trading platforms. This caused significant concern as the source code had been licensed by his employer to many clients.

CD: If suspicion falls on a current or former employee, what immediate steps should a company take?

Coyne: From a security perspective, no former employees should have access to any of their previous company accounts or any data held by the company. If it is suspected that they are still accessing something, the first thing to do is reset passwords and ensure permissions won't allow that individual to access anything else. From there, it may be necessary to instruct an expert in order to test systems and understand what further steps need to be taken in a specific instance. With current employees it is more difficult. You can take away user access, but then you will be losing a resource, and in any case they may have already transferred whatever data they needed to a separate media. We would always recommend that a forensic image is taken of an employee's PC hard drive along with any mobile phones with which they have been accessing company data. This should be done immediately on the day of leaving and if there is any suspicion, then before that. If this is covered in the employee's employment terms and conditions it allows for a

> **"If there is only the opportunity to make one change to your security policy this year, then consider introducing and running a BYOD policy."**
>
> *David Anthony Sykes, IT Group UK Ltd*

simple route of access should any investigations need to commence.

Sykes: Visibility of the processes is a key weapon. If employees know that their hard drives and mobile phones will be imaged, they will think twice before quietly copying the client lists, 'just in case'. Of course, the really savvy thieves may just then take extra precautions but on balance I think it is better for staff to know that you not only have a right to protect your data and to interrogate the computers and phones you provide to employees for them to carry out their duties, but that you will be doing that if they leave. The single highest risk to company data security in my view is the massive surge in BYOD, or Bring Your Own Device. While statistics vary depending upon their source and currency, all seem to indicate that BYOD makes employees more efficient but a very high percentage of BYOD is completely unmanaged. If there is only the opportunity to make one change to your security policy this year, then consider introducing and running a BYOD policy.

CD: Are search and seizure orders for homes and business premises becoming more common? How can this approach assist the forensic process? And what, if any, are the potential downsides?

Coyne: We have certainly seen more search and seizure orders recently. As they are typically ex-parte they can greatly assist the value of the forensic process simply because it is less likely that evidence can be tampered with or even removed all together. Judges in England do require evidence of the defendant's past actions taken in attempting to 'cover up' any actions, or to demonstrate a 'forensic awareness' by wiping computer hard drives or memory sticks before they will grant an ex-parte search order.

Sykes: It is a very effective tool in the reduction of incidents to publicise the effectiveness of search and seize. The real prize is that the threat of high cost litigation and the complete uncertainty that results from a complete set of forensic images being done under your nose and without warning combine to make dishonest ex-employees opt for a confession early in many cases.

CD: Are there certain types of company which are particularly at risk of cyber related employee theft – or do all organisations need to manage this risk?

Coyne: Every organisation should take reasonable steps to ensure that sensitive information is secure. However, obviously those companies which hold the most valuable data – such as financial institutions – should ensure that their systems and processes

are regulated by the tightest controls, as they are more likely to be targets. Any organisation where ex-employees may seek to establish competing business will also be targets from the theft of material that would allow the new fledgling company to advance swiftly. Typically such material will be customer or prospect lists and product design and manufacture plans or processes.

Sykes: The biggest risks are in companies that invest heavily in research and development, whether that be in the development of new drugs or in the creation of software that performs sophisticated algorithms. The intellectual property in such work is usually huge, and the incentive either to take that IP and set up in competition or to join existing competition, can be too much for some ex-employees.

CD: What strategies should companies adopt to enhance their internal cyber security? How important are stringent processes and controls around data access? Is it also important to raise awareness and educate employees on the risks of compromised business data?

Sykes: It is essential that there are policies in place for the use and maintenance of the systems that staff use on a day-to-day basis. These policies must be embedded in the HR systems so that employees have the highest exposure to them. However, without regular testing and risk assessment, policies on their own are useless. I recommend vulnerability assessments are routinely carried out on a periodic basis with full Pen Testing being scheduled at less frequent intervals. One of the least considered risk assessments in my experience is the consideration of access to data on a 'need to know only' basis.

Coyne: It is vital that staff understand the magnitude of their actions with regard to data, and that they understand the necessary processes. If employees are not aware that their actions could potentially harm the business, they are less likely to carry out those actions with care and scrutiny. Simple things, such as enabling two-factor authentication on email accounts, using strong passwords and changing them regularly, are some of the simplest and most effective ways to protect sensitive information. When assessing cyber security, it often shocks executives how poor the perimeter security is at protecting from phishing attacks from ex-employees. Ex-employees, because of their knowledge of the employer's systems and processes, can be quite convincing in creating phishing emails with the correct 'look and feel' that may lead the current employees to be fooled by them.

CD: Is cyber related employee theft set to become a major problem in the years ahead? Are companies doing enough to protect themselves against data loss deriving from disgruntled or malicious employees who gain access to critical data?

Sykes: With the increase in BYOD, and the real prospect of the Internet of Things (IoT) mushrooming, cyber related crime and employee theft in particular is set to become the biggest problem facing companies in the years ahead. The 'take home' thought about the IOT is that for it to work effectively, access is granted to devices inside your secure network from outside. Many of these devices do not have and cannot have conventional security deployed. It is not possible, for example, to have anti-virus software on the toaster in the staff canteen – and yet an internet enabled toaster has been around now for at least seven years.

Coyne: Cyber related employee theft is already a major problem and, while some companies do take steps to protect themselves, many still do not. I would encourage companies to implement regular consolidated threat scanning. It is relatively low cost and statistically will pick up on a significant percentage of the current threats out there. Create a culture of your employees being aware of you obtaining regular forensic images of the works computers and mobile phones. This will reduce the prospect of employees considering exploiting their positions. CD

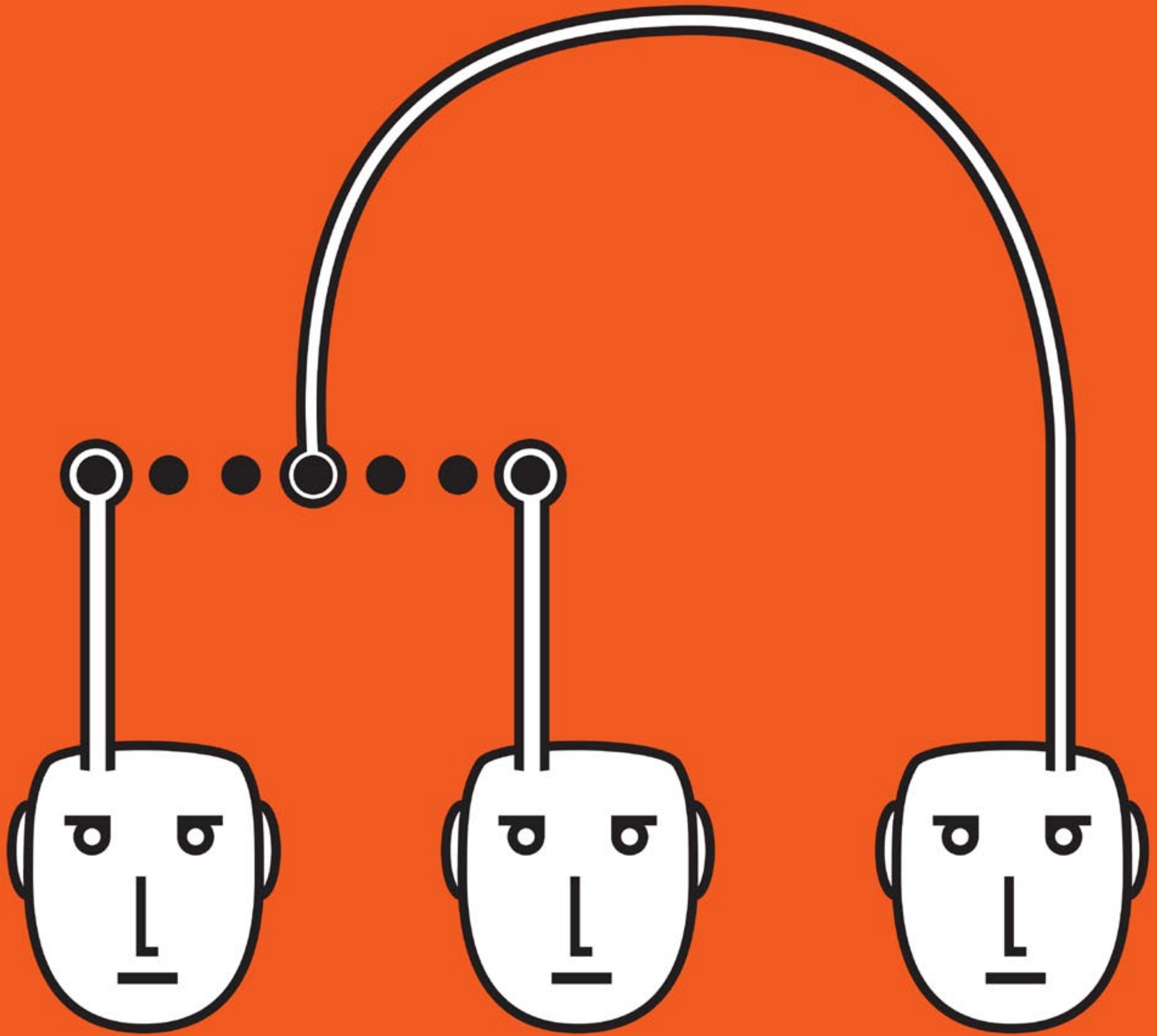
PERSPECTIVES

THREE'S COMPANY: HOW ATTORNEY-DIRECTED INFORMATION GOVERNANCE PROJECTS WITH CLIENTS AND CONSULTANTS CAN PROTECT THE ATTORNEY-CLIENT PRIVILEGE

BY **JUDY SELBY AND MELISSA KOSACK**
> BAKERHOSTETLER

As volumes of data continue to explode and companies become more data-dependent, the need for companies to implement information governance practices to get their 'data houses in order' rises in tandem.

The proactive retention of outside counsel for the strategic implementation of information governance – the coordinated management of the information lifecycle within and without the client firewall – can help to establish the attorney-client privilege



and shield highly sensitive communications from disclosure.

To understand the complexities of a company's computer networks and information management practices, companies often need the assistance of specialised third-party consultants. When such consultants are retained directly by outside counsel, communications among the consultants, outside counsel and the company are more likely to fall within the umbrella of privilege than if the

consultants were retained directly by the company itself. Outside counsel's management of this tripartite relationship can help to create a 'cone of protection' around the development of information governance policies, including enterprise-wide security assessments, legacy remediation, and Big Data use policies. This can help the company preserve privilege and prevent production of potentially harmful communications and internal assessments in any subsequent litigation or regulatory investigations.

The attorney-client privilege – the most sacred tenet of litigation – serves "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice". *Upjohn Co. v. United States* (449 U.S. 383, 389 (1981)). It shields from disclosure "communications (1) between a client and his or her attorney (2) that are intended to be, and in fact were, kept confidential (3) for the purpose of obtaining or providing legal advice". *United States v. Mejia* (655 F.3d 126, 132 (2d Cir. 2011)).

While the golden rule of the attorney-client privilege prohibits disclosure to third-parties for fear of waiver, the Second Circuit has recognised an exception known as the *Kovel* doctrine. *See United States v. Kove*l (296 F.2d 918 (2d Cir. 1961)). The attorney-client privilege is not abrogated if the party claiming the privilege possesses a reasonable expectation of confidentiality and the involvement of the third-party in these communications was 'necessary' for the provision of informed legal advice from counsel. "The necessity element goes beyond mere convenience and 'requires [that] the involvement [of the third party] be indispensable or serve some specialized purpose in facilitating the attorney client communications.'" *Cohen v. Cohen* (2015 WL 745712, at *3 (S.D.N.Y. Jan. 30, 2015)).

"While the golden rule of the attorney-client privilege prohibits disclosure to third-parties for fear of waiver, the Second Circuit has recognised an exception known as the Kovel doctrine."

Notably, *Kovel* cautioned "[w]hat is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer. If what is sought is not legal advice but only [non-legal services] . . . or if the advice sought is the [consultant's] rather than the lawyer's, no privilege exists". The *Kovel* court analogised

attorney comprehension of the accounting field with translators for foreign language-speaking clients because accountants and translators serve similar functions for the "effective consultation between the client and the lawyer which the privilege is designed to permit". Given that virtually every company is now a digital company, third-party consultants have become the consummate and often vital 'translators' to assist attorneys in providing sound legal advice.

In re Target Corp. Customer Data Security Breach Litigation (2015 WL 6777384 (D. Minn. Oct. 23, 2015)) highlights the interplay of the attorney-client privilege and the involvement of outside counsel in the implementation of information governance projects. In response to class plaintiff financial institutions' motion to compel Target's production of documents regarding its investigation into the causes and remediation of the 2013 data breach, Target propounded their development of a 'two-track' investigation. The first 'ordinary course' track involved a non-privileged investigation by Target's incident response team and an outside consultant team from Verizon. For the second track, Target hired outside counsel, who, along with in-house counsel, formed a Data Breach Task Force (DBTF). To understand Target's complex computer systems and provide informed legal advice on potential litigations and regulatory inquiries, outside counsel retained a second consultant team from Verizon ('Privileged Verizon'). The retention letters highlighted the scope of Privileged Verizon's engagement and specified that its services and communications were to be treated as confidential and performed at the direction of outside counsel to assist in the provision of legal advice to Target. Outside counsel had its imprimatur on all aspects of this relationship by participating in virtually every communication, directing all interactions between Target and Privileged Verizon, and editing Privileged Verizon's reports.

Critically, the court held that almost all of the second track communications were protected from disclosure by the attorney-client privilege and the work-product doctrine. DBTF-related emails were protected because the DBTF "inform[ed] Target's in-house and outside counsel about the breach so that Target's attorneys could provide the company with legal advice and prepare to defend the company in litigation that was already pending and was reasonably expected to follow".

Two recent Southern District of New York cases demonstrate the perils of companies failing to meet the *Kovel* criteria. In *Scott v. Chipotle Mexican Grill, Inc.* (94 F.Supp.3d 585 (S.D.N.Y. 2015)) and *Church & Dwight Co., Inc. v. SPD Swiss Precision Diag*. (2014 WL 7238354 (S.D.N.Y. Dec. 19, 2014)), the courts concluded that communications with third-party human resources and marketing consultants did not qualify for protection because they failed to "clarif[y] or facilitat[e] communication between attorney and client in confidence for the purpose of obtaining legal advice from the attorney".

Importantly, retention of consultants by in-house counsel may not provide as strong a basis for the application of privilege as would retention by outside counsel. Given the proactive nature of many information governance projects, there is a potential for in-house counsel's activities to be perceived not as legal advice but as ordinary business advice, which may fall outside of the protections of the attorney-client privilege. Courts may interpret exclusive reliance on in-house counsel as a business initiative that would have been undertaken even without counsel. Outside counsel's provision of legal guidance regarding the anticipatory development of information governance infrastructure and risk evaluation in connection with compliance or potential litigation or regulatory concerns, however, can help to preserve the privilege.

As 'lessons learned', companies should give strong consideration to the retention of outside counsel at the outset to implement and orchestrate information governance 'best practices'. When retaining consultants, outside counsel should document in the engagement letter that the consultant's services are being rendered to assist counsel with understanding the client's information practices. The letter also should note that these services, as well as all related communications, including the receipt and provision of information, are to be considered confidential and privileged. In addition, the letter should enumerate the reasons why counsel needs 'translation' of the complicated data into a 'usable form' to provide informed legal advice.

Throughout this tripartite relationship, clients should continuously strive to document that the consultant was hired to facilitate counsel's comprehension of technical issues and the performance of legal services. Infusing the protections of the attorney-client privilege into outside counsel-consultant communications helps to prevent the waiver of privilege. CD

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PERSPECTIVES

THE FRADE OIL SPILL LITIGATION AND BRAZILIAN ENVIRONMENTAL LAW

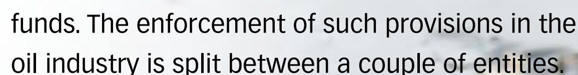
BY **ARTUR WATT NETO**
> NATIONAL AGENCY OIL, NATURAL GAS AND BIOFUELS

In November 2011, an accident during the drilling of a well in the Frade Field, 75 miles offshore Rio de Janeiro state, Brazil, caused the spill of approximately 3700 barrels of oil into the sea, generating the biggest media coverage and public outcry for such an event in Brazil – although it cannot be called the worst in Brazil's history.

Yet, the Frade oil spill had massive press coverage and originated criminal charges and multibillion damages lawsuits. This article's goal is to explain the legal landscape prior to the accident, the accident itself and the ensuing litigation, and point out some room for improvement in regulations and statutory law.

The Brazilian Constitution and environmental laws are progressive, treating environmental damages as a loss to society as a whole rather than just to landowners or even people directly affected by pollution.

Brazilian Law defines environmental damages very broadly, and Law 6,938/1981 expressly states that pollution can cause recoverable damages to third parties and to 'the environment' itself. The liability for such damages is strict. Environmental scholars agree that this strict liability applies not only to individual and quantifiable damages, but also to economic compensation collected by society through environmental and social compensation

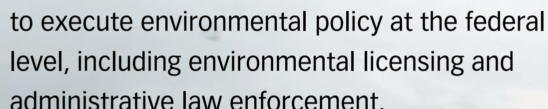


funds. The enforcement of such provisions in the oil industry is split between a couple of entities.

ANP, the national agency in charge of regulation of the petroleum industry, has a broad jurisdiction, ranging from upstream to downstream, from assigning contracts to regulating the execution of activities. This one-stop-shop model, however, is not absolute. ANP was created in 1997 by Brazil's Petroleum Act, as the federal agency responsible for overseeing the whole oil & gas sector, following liberal reforms in the 90s aimed at reducing the direct state participation in the economy in favour of a regulation and taxation regime. ANP is deemed as an autonomous agency, but it is part of the executive branch and is linked to the Ministry of Mines and Energy (MME).

Brazilian Law sets the penalties that can be imposed by ANP. However, these figures were set in 1999 and were never updated, in spite of an inflation of 227 percent in the 17 years following the enactment of this statute. This way, the biggest possible fine for a single breach of a safety standard is still BRL 2m, which now converts into less than US$500,000. Considering the magnitude and the risks involved in deep offshore operations, an update to the maximum amount of fines – and even a steep increase – are greatly overdue.

IBAMA is the national environmental enforcement body, created in 1989, just after the new constitution, by federal Act 7,735/1989,



to execute environmental policy at the federal level, including environmental licensing and administrative law enforcement.

If a project is subject to federal environmental oversight, then IBAMA is responsible for approval of the environmental impact assessment and issuing a licence. The criteria for federal oversight are generally the relationship to federal property and interest such as the ocean, federal lands, interstate and international rivers, first nation lands, nuclear projects and projects located or with an impact in more than one state.

IBAMA has the power to apply administrative penalties for any actions that "break the rules of use, promotion, protection and recovery of the environment". These fines could reach up to BRL 50m.

Ministério Público Federal (MPF), the Brazilian Public Prosecutors' Office, is responsible for the prosecution of all criminal offences and damages litigation on behalf of "public and social assets, the environment and other diffused and collective interests". The Brazilian Constitution of 1988 gave this institution total independence from the executive branch, leading to the epithet of 'the fourth branch'.

The oil spill

During the drilling of a well in the Campos basin, a kick occurred. The primary safety mechanism

– the blowout preventer – worked properly and shut the flow down. However, the increase in the pressure caused by the shutdown led to an underground blowout, whereby the reservoir integrity was breached at 2300 feet below the seabed. The oil then moved through natural underground fractures until it reached the seabed and then the ocean.

The ANP report on the accident pointed to a series of flaws in the lessee's procedures, such as: mistakes in the interpretation of the geology and hydrodynamics of the reservoir, injecting water that led to a higher pressure increase than expected; underestimating potential well pressures, in the light of data from previous wells; the well killing technique deployed to kill the well was inadequate; it took two days for the lessee to notice that the underground blowout was not immediately resolved, even with oil visible on the sea in the nearby region, which meant the underground blowout was fully controlled only after six days.

The well was only cased up to 2000 feet below the seabed, despite international literature indicating that the formation is likely to be fractured up to the seabed when an underground blowout occurs at depths below 3000 feet, so a well should be cased up to this depth. The Frade underground blowout occurred exactly between the recommended casing depth and the actual casing depth.

In its initial public response, Chevron rejected most of the conclusions of ANP report, stating that the model for the drilling plan was calibrated taking into account available data, the safety margins were within "industry best practices", and the response was handled properly and on time.

Criminal charges

All the criminal actions were initiated in 2011, before the conclusion of the ANP report, reflecting the autonomy – and, arguably, the lack of communication – of the criminal system and the rest of the executive branch.

Initially, the Federal Police indicted Chevron, Transocean and 17 staff for committing four crimes described in the Environment Protection Act and making false statements. The combination of the aforementioned crimes could result in extensive jail time.

Due to the seriousness of the alleged conduct and the potential flight risk of foreign employees, the federal criminal prosecutor of the closest city – Campos dos Goytacazes – requested seizure of the employees' passports, which was granted by a federal judge. Later, some of the passport seizures were lifted as the employees demonstrated their need to travel home and promised to appear in court.

On 18 February 2013, a federal judge decided to dismiss the charges without proceeding to trial. In his decision it was stated that even as negligence was likely to be found, the criminal charges would require criminal intent, and wilful misconduct was not even stated in the charges. In fact, it would

be contrary to the business ethic to purposefully commit the alleged conduct.

The federal prosecutor that appeared before a lower federal judge appealed this decision, only in regard to Chevron and its employees, having dropped the charges against Transocean and its employees.

On 9 October 2013, the appeal was decided by the 2nd Circuit Federal Court of Appeals in Rio de Janeiro (TRF2). Oddly, the Federal Prosecutor appearing before the Court of Appeals requested the denial of the appeal filled by his lower peer. However, the three-judge panel decided in a majority decision to partially alter the decision and keep the indictment of Chevron and 11 of its employees for two of the crimes originally charged.

Because the decision was not unanimous, the defendants are entitled to a new appeal before a six-judge panel at the same court of appeals, which is yet to be decided.

Administrative penalties

Initially, in the aftermath of the accident, ANP suspended Chevron's activities in Brazil (which were limited to the Frade Field operation) until further notice. This was followed by technical investigations that culminated in the aforementioned report and in the imposition of 24 penalties due to breaching ANP regulations, with fines totalling BRL 35m. Many of the fines were set up at the BRL 2m statutory limit. All these penalties were related exclusively to offshore safety regulations.

In March 2013, ANP allowed Chevron to resume production in the Frade Oilfield and authorised the drilling of two new production wells, but kept the drilling of new injection wells suspended, until it was proved that new water injection would be safe and would not lead to unexpected pressure elevations and further leakage.

> **"All the criminal actions were initiated in 2011, before the conclusion of the ANP report, reflecting the autonomy – and, arguably, the lack of communication – of the criminal system and the rest of the executive branch."**

On the environmental front, IBAMA imposed on Chevron a BRL 50m fine for the oil spill, and another BRL 10m for failure to comply with the emergency plan presented for environmental licensing.

Damages litigation

Besides the criminal charges mentioned above, the Federal Prosecution Office sued Chevron, Chevron Brasil and Transocean for BRL 20bn in environmental

damages. Later, when the second spill came out, a new suit was brought for another BRL 20bn.

There was great criticism among the oil and gas legal community, because the values were calculated without any factual support. A Brazilian senator (from the same party as the president) called these numbers "irresponsible". In the lawsuits, the federal prosecutor compared this accident to the Macondo disaster in the Gulf of Mexico, in which the compensation had been estimated in the eleven-digit range by that time.

However, the proportion of these two accidents could not be compared. In Macondo, the oil spilled was estimated at 3.19 million barrels and directly impacted a sensitive coastal ecosystem. In Frade, the spill was much smaller and didn't reach the coast. Chevron repeatedly claimed that no actual environmental damage took place, but some experts dispute these allegations.

This kind of approach to setting damages claims can be explained by a series of factors: the absence of any judicial costs and fees to be paid by the Federal Prosecutors' Office, the media attention brought by the big values claimed, and the negative opinion shared by many people in Latin America about foreign oil companies.

Later, a settlement was reached between the plaintiff and defendants, with the participation of ANP and IBAMA. Chevron committed itself to take a series of measures to improve operational safety, invest BRL 95m in socio-environmental compensation projects, and pay all administrative fines. The reduction of the total amount paid is evidence of the poorly estimated initial claim.

In Brazil, the statutory fines for both environmental and safety issues are capped in global amounts per infraction. These values were set many years ago by Congress and were not updated, as regulators repeatedly insist.

In the Frade accident, the total fines amounted to BRL 60m, or about US$4000 per barrel, which could indicate a standard similar to US legislation. Combined with the amount directed to compensation funds by settlement, it looks like adequate deterrence against this kind of infraction.

However, this value was a combination of two fines by IBAMA and 25 by ANP, most of them at the statutory maximum. In a scenario of greater scale spill or single infraction, high consequence pollution, the authorities could be caught shorthanded with disproportionately low penalty limits.

This should lead to a broader revision of the caps on fines. Of course, the number of barrels thrown into the environment should not be taken as the single measure of the seriousness of pollution (as it is not in the United States), although it is a good proxy. In addition, this kind of approach provides strong economic incentives for greater vigilance in especially dangerous operations, as well for the fastest response possible in the event of an accident.

Brazil should follow the global trend to improve its legislation on oilfield safety. Congressional action is required to enforce regulatory autonomy and increase the outdated limits of existing penalties. The momentum for this has passed by, but Congress should not wait for another disaster before it takes action. CD

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PERSPECTIVES

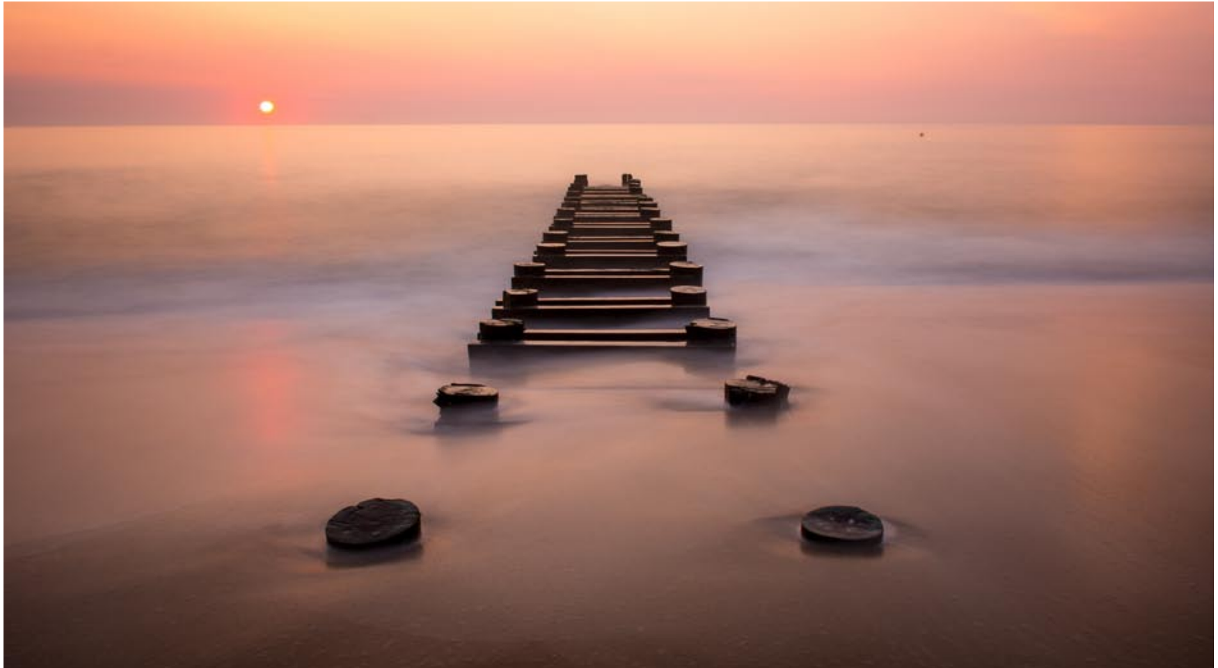
THE CLEANSING EFFECT OF A STATUTORILY REQUIRED SHAREHOLDER VOTE ON A TROUBLED TRANSACTION

BY **STEPHEN B. BRAUERMAN AND SARA E. BUSSIERE**
> BAYARD, P.A.

Delaware law has long recognised that the uncoerced vote of fully informed stockholders can cure even the most questionable of self-interested transactions. This policy is enforced through the standard of review Delaware courts use to judge these otherwise interested transactions. This article discusses Delaware's increasing comfort with the curative powers of fully-informed stockholder votes, as evidenced by the Delaware Supreme Court's recent decision in *Corwin v. KKR Financial Holdings, LLC,* in which the Court extended deferential judicial review to transactions approved by a majority of disinterested stockholders, even where the stockholder vote was statutorily required. *Corwin* exemplifies the sanitising benefits of a vote – even when the company did not call the vote for its sanitising effect.

Delaware's standards of judicial review

The standard of review determines the deference the court will apply in reviewing a challenged



transaction and is often outcome determinative. Thus, the application of the appropriate standard of review is "essential to a proper judicial review of challenges to the decision-making process of a corporation's board of directors". *Omnicare, Inc. v. NCS Healthcare, Inc.,* 818 A.2d 914, 927 (Del. 2003). Delaware courts employ three levels of judicial review: (i) the business judgment rule; (ii) enhanced scrutiny; and (iii) entire fairness.

The business judgment rule, the most deferential standard, reflects the "cardinal precept of the General Corporation Law of the State of Delaware... that directors, rather than shareholders, manage the business and affairs of the corporation". As such, under the business judgment rule, Delaware courts will uphold corporate decisions "absent an abuse of discretion". However, a plaintiff may rebut the business judgment rule in various ways, including by showing that a controlling stockholder stood on both sides of the transaction, a majority of the board was interested in a particular transaction or lacked independence, or that the board failed to act in good

faith in approving the transaction. *Id.; see also eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 36 (Del. Ch. 2010).

If a plaintiff successfully rebuts the business judgment rule, the burden of proof shifts to the defendant director to prove that the challenged transaction was entirely fair to the company – an exacting standard. Entire fairness requires the defendant director to "establish to the court's satisfaction that the transaction was the product of both fair dealing and fair price". *Cede & Co. v. Technicolor*, 634 A.2d 345, 361 (Del. 1993) (emphasis in original). Somewhere between the business judgment rule and entire fairness lies enhanced scrutiny, an intermediate level of judicial review that requires the defendant director to prove that the actions he or she took were reasonable". *Paramount Communications Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 2000).

"If a plaintiff successfully rebuts the business judgment rule, the burden of proof shifts to the defendant director to prove that the challenged transaction was entirely fair to the company – an exacting standard."

Corwin and mandatory votes

In *Corwin*, the Delaware Supreme Court affirmed the dismissal of a complaint for breaches of fiduciary duty, and aiding and abetting such breaches, because "the voluntary judgment of the disinterested stockholders to approve the merger invoked the business judgment rule standard of review", which plaintiffs failed to rebut. Plaintiffs' claims arose from a stock-for-stock merger whereby KKR & CO. L.P. (KKR) acquired KKR Financial Holdings LLC (KFN).

Plaintiffs argued the Court should apply entire fairness review because KKR, which held less than 1 percent of KFN's stock, constituted a controlling stockholder and a majority of the KFN board lacked independence. After finding that it could not reasonably infer from the well-pled facts that KKR could prevent the board from exercising its independent judgment, the Court of Chancery found that the fully informed, uncoerced vote of disinterested stockholders invoked the business judgment rule.

In reaching this conclusion, the Court of Chancery relied upon longstanding Delaware precedent to hold that the "legal effect of a fully-informed stockholder vote of a transaction with a non-controlling stockholder is that the business judgment

rule applies and insulates the transaction from all attacks other than on the grounds of waste, even if a majority of the board approving the transaction was not disinterested or independent". The Court of Chancery rejected a recent interpretation of the Delaware Supreme Court's decision in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), which suggested that a statutorily mandated stockholder vote altered this precedent ("I do not read *Gantler* to have altered the legal effect of a stockholder vote when it is statutorily required").

On appeal, the Delaware Supreme Court agreed with the Chancellor's finding that the uncoerced, informed stockholder vote was outcome-determinative. The Court wrote: "To erase any doubt on the part of practitioners, we embrace the Chancellor's well-reasoned decision and the precedent it cites to support an interpretation of *Gantler* as a narrow decision focused on defining a specific legal term, 'ratification,' and not on the question of what standard of review applies if a transaction not subject to the entire fairness standard is approved by an informed voluntary vote of disinterested stockholders. This view is consistent with well-reasoned Delaware precedent".

The Supreme Court rejected plaintiffs' argument that such a reading impairs existing stockholder protections, or exposes stockholders to abuse by directors without adequate protections. The Court explained that "the doctrine applies only to informed, uncoerced stockholder votes, and if troubling facts regarding director behaviour were not disclosed that would have been material to a voting stockholder, then business judgment rule is not invoked". In the present matter, KKR's interests were fully disclosed to the stockholders and therefore, the Court of Chancery properly dismissed plaintiffs' claims ("for sound policy reasons, Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority that determines that a transaction with a party other than a controlling stockholder in their best interests").

Zale **and** ***Corwin*****'s immediate impact**

Corwin's confirmation that business judgment review applies to stockholder approval of an interested transaction, even where such stockholder vote is required by statute, had immediate impact. The Delaware Supreme Court issued *Corwin* on 2 October 2015. The day before, the Court of Chancery decided *In re Zale Corporation Stockholders' Litigation*, 2015 WL 5853693 (Del. Ch.), in which it denied a motion to dismiss aiding and abetting claims against Zale Corporation's (Zale) financial adviser, Merrill Lynch, Pierce, Fennell, & Smith Inc. (Merrill Lynch).

Zale involved a post-merger challenge to the all-cash acquisition of Zale by its chief competitor, Signet Jewelers Ltd. (Signet). The plaintiff alleged that the Zale board of directors breached its fiduciary duties of care and loyalty by undermining the board's ability to maximise shareholder value through

undisclosed conflicts of interest and an unfair sales process. Merrill Lynch aided and abetted the board's breaches, according to the plaintiff, by, among other things, making a presentation to Signet extolling a potential acquisition of Zale while it had access to Zale's confidential information. After announcing the merger, several large institutional stockholders publicly expressed their opposition, in response to which Zale made a number of filings with the Securities and Exchange Commission extolling the virtues of the transaction. With these substantial disclosures, a bare majority of Zale stockholders voted to approve the merger.

Even though a majority of Zale's public stockholders voted to approve the merger, the Court of Chancery applied enhanced scrutiny to review the transaction because after the Zale board decided to sell the company, it had an obligation under *Revlon, Inc. v. MacAndrews & Forbes Hldgs*., Inc., 506 A.2d 173, 182-3 (Del. 1986) to take all reasonable steps to maximise the value of transaction. Aware of the tension between *Gantler* and the Court of Chancery's decision in *KKR* (which was then on appeal), the *Zale* Court conservatively declined, "until the Supreme Court signals otherwise", to apply business judgment review to a challenged transaction approved by a majority of fully-informed and disinterested stockholders because the stockholder vote was required under Section 251 of the DGCL.

Applying the more stringent enhanced scrutiny standard, the Court of Chancery found that it was reasonably conceivable that Merrill Lynch aided and abetted a breach of fiduciary duty because the Zale board did not learn about Merrill Lynch's presentation to Signet until after the merger agreement was signed and the Court denied Merrill Lynch's motion to dismiss.

The Supreme Court issued *Corwin* the next day. Under *Corwin*, business judgment review applies to a transaction approved by a fully informed majority of disinterested stockholders even where that stockholder vote is statutorily required. Citing Corwin, Merrill Lynch timely moved for reargument of the *Zales* decision. *Corwin* offered the "signal" for which the *Zale* Court was looking. The Court of Chancery granted Merrill Lynch's motion for reconsideration in light of *Corwin* because it "misapprehended the cleansing effect of a fully informed, statutorily required vote by a majority of disinterested stockholders".

On reconsideration and after applying the deferential business judgment rule, the Court of Chancery found that the board's investigation of Merrill Lynch's alleged conflicts and its ultimate decision to retain Merrill Lynch were not grossly negligent and could not support the breach of fiduciary duty claim on which the aiding and abetting claim against Merrill Lynch necessarily rested. Even though the Court found "the conduct of Merrill Lynch in this case troubling", the fully informed stockholder

vote saved Merrill Lynch and the Court dismissed the claims it previously sustained against Merrill Lynch under the less onerous business judgment standard.

Conclusion

The *Corwin* decision and the Court of Chancery's self-correction in *Zale* following *Corwin* demonstrate the cleansing power of a fully informed vote of disinterested stockholders. Even when a stockholder vote is statutorily required (i.e., to approve a merger or a sale of all or substantially all of the assets of a company), the curative effects of the vote remain. As such, corporate actors can take solace knowing that if they can convince their stockholder constituencies – after full disclosure – of the merits of the deal, Delaware courts will not lightly second guess them. CD

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PERSPECTIVES

THE INCONVENIENCE OF CONVENIENCE

BY **HOWARD B. BORLACK AND BEN CARINO**
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If you remember surfing the information superhighway on Netscape Navigator, then you probably experience déjà vu when you read about Uber's legal troubles. Uber is a smartphone application that connects people with drivers. Press a few buttons on your phone and – presto – a car arrives to pick you up. Less magical are the regulatory problems caused by Uber's entry into the people-moving business, which is occupied by taxicabs, taxi brokers and limousine companies who follow heavy regulations in exchange for a captive marketplace. Every major city worldwide is dealing with this issue.

Industry-disrupting companies like Uber have been around since the birth of the internet. Because they use an inherently intangible medium in unanticipated ways, these companies often operate in regulatory grey areas. Naturally, lawmakers can only draft for the reasonably foreseeable future. Hence the historical disconnect between digital innovators and the law.

"Industry-disrupting companies like Uber have been around since the birth of the internet. Because they use an inherently intangible medium in unanticipated ways, these companies often operate in regulatory grey areas."

Numerous examples abound. Napster facilitated the free exchange of licensed, digital music in

1999. Google scanned copyrighted library books and shared excerpts online at no cost when it launched Google Books in 2004. Google Street View contravened privacy laws by capturing sensitive personal information from unsecured wireless networks during the mid-2000s. More recently, Airbnb has facilitated the short-term rental of private apartments without remitting hospitality taxes in some jurisdictions.

Uber's current legal fortunes vary by region. They are banned in Germany, Italy and Rio de Janeiro but operate freely in China and Mexico City. Meanwhile in Canada, two recent decisions from Alberta and Ontario have given hope to the Uber cause.

In *Edmonton (City) v Uber Canada Inc*, 2015 ABQB 214, the Court of Queen's Bench denied an interlocutory injunction to enjoin Uber Canada from conducting business. In her ruling, Justice Crighton remarked that there was no evidence that Uber Canada received a fee for each ride. In fact, the evidence failed to locate Uber Canada's registered office address or describe "how and from where" Uber engages in the activities alleged against it.

Different evidentiary challenges were faced in *City of Toronto v Uber Canada Inc. et al*., 2015 ONSC 3572, where the City of Toronto sought an injunction requiring Uber to apply for a licence to conduct its business. In his ruling, Justice Dunphy found that Uber's services did not fall within the narrowly drafted provisions of the City of Toronto Act (the Act), which presently regulates the taxicab industry.

Especially notable was the paucity of evidence with respect to key issues. None of the core aspects of the Uber model – marketing, recruiting drivers, billing passengers – fell within the regulated activities in the Act. Uber was neither a 'taxicab broker' nor a 'limousine company'. Uber did not 'accept' communications from passengers. In fact, the evidence failed to identify the owner or operator of the Northern California server used to relay data between passengers and drivers.

Ultimately, the Uber issue may be decided by political forces rather than legal ones. Licensed taxi cabs and regulated livery services want Uber banned. The safety, insurance, tax and licensing requirements imposed on taxicab operators are crafted by local government in the public interest. The decision to impose these same public safeguards on Uber may well entail overriding policy considerations beyond the reach of the courts. CD

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PERSPECTIVES

SHOULD BUSINESSES HAVE SOULS?

BY **TONY BELAK**
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If a corporation is considered a person in a legal sense, it must also act as a person would in a position of responsibility to its community of all stakeholders, not just shareholders. It is presumed this person would not have a personality defect or mental illness and would operate as though it has a soul, complete with values, ethics, morals, a sense of purpose and a reason for being. Without modelling and encouragement from top management and genuine adherence to the meaning of these words, a business may have a life but not a soul.

Employee trust and commitment to their organisations are in decline, yet trust and commitment are essential for every corporation's performance and sustainability. Trust in the workplace is essential for durable, satisfying and rewarding relationships. It is achieved through productive communication, understanding and respect. Distrust breeds conflict and this can consume time and energy, diverting management attention from more profitable activities and outcomes. Trust is one's assessment that another will not deliberately, accidentally, consciously or unconsciously take unfair advantage. It is a person's hope and belief that the trustee will protect and preserve one's self-esteem, status, relationship, career and even life. We must behave consistently over time to build trust and follow through on promises made.

In order to achieve this level of trust, expectations must be explained with agreement to necessary steps to complete expectations, sanctions for not meeting expectations, and procedures to measure outcomes. Trust contains a strong emotional component, and parties should be able to share their expectations for one another, negotiate for expected behaviours and openly acknowledge mutual distrust. Expectations are created with or without collaboration, and unilateral expectations, when broken, often cause the most harm.

A recent Gallop Poll confirmed that the most often cited reason employees leave their organisation is because of their boss. Bad bosses contribute to the corporate culture through incivility, interpersonal mistreatment, psychological harassment or abusive conduct via antisocial behaviour and aggression directed to another. Nearly half of American workers would fire their boss if allowed and 30 percent would refer their boss to a psychologist. Corporate

values that offer reward for performance must include more than mere monetary exchange for time in place; it must offer recognition, communication and trust. Simple training programmes are not enough and high commitment businesses must work hard to sustain their healthy cultures.

Businesses must establish policies and encourage practices that reflect the values of compassion, authenticity in relationships, fairness and trust. For example, bullying has been associated with high turnover, absenteeism, presenteeism, disengagement and loss of productivity. It is a drain on the efficiency and effectiveness of the organisation, and employers should act proactively to establish practices and policies to prevent it. Many European Union countries have enacted regulations and policies against this abhorrent behaviour, but the United States has not yet created rules to address workplace bullying.

Dr Michael Linden, a German psychiatrist, has postulated that people may become so embittered by negative life events that normal functioning is impaired. Post traumatic embitterment disorder (PTED) includes severe depression, feelings of helplessness, disrupted sleep, aggression and even suicidal ideation. This extreme negativity lasts longer than three months and impairs performance in daily activities (Psychotherapy and Psychosomatics, 2003).

David C. Yamada, from Suffolk University Law School, has spoken and written extensively on the epidemic of workplace bullying and its adverse impact on the individual and organisation. He notes that acknowledging embitterment as a potential and normal consequence of bullying in the workplace can be an important piece in the recovery process.

Recent research by Kimberly M. Castle, Ph.D., Sullivan University, 2014, reveals the four emerging categories of motivation identified by bullies for using bully tactics. She identified: (i) justification (the need to get the job done at all cost, my reputation, and being counted on), with sub-categories of (ii) entitlement (no one can do it better than me thinking); (iii) integrity (I am right and I am being moral); and (iv) self-righteousness (failure is not an option thinking and the work must get done a certain way and that is my way; if I apologise it is justified). All four concepts have in common self-focus by the bully, which reflects low emotional intelligence. Bullying can lead to embittered people targeted for what may be viewed as good reasons by the bully.

Injury to dignity touches the individual's core and is an assault on our existence, our soul, our *raison d'etre*. When the individuals who compose an organisation are viewed collectively as the organisation, injuries to respect, dignity, self-esteem and intentional psychological assault damage the collective. Core values to promote trust, diversity, personal and professional growth, mutual respect and constructive communication are absolute requirements in a healthy and vibrant business. People who bully for the good of the organisation are inhibiting excellence in others and seeking

advancement for themselves on the trash heap of lost creativity, engagement, loyalty and the aspirations of victims, who become lost souls.

One intrinsic quality we all possess is to strive toward being the best we can be. This quality makes us more creative, informative, thoughtful and industrious. We are aware and informed of external factors in technology, science, medicine, arts and existing in a world with data-driven decision making. External studies can be a guide to success but not the answers to essential questions, such as why am I here, what is my purpose, and what is my role? This internal conundrum can be motivating for confident and secure individuals who accept their assumptions, but most seek answers and guidance through daily grinds and duties, while interacting with others who may also suffer from confusion and ignorance. The intersection of wants, needs and expectations is where we interface with others — it can be a workplace, a home or anywhere where continuing relationships occur.

When compassion is practiced, recent developments in brain science reveal that humanistic factors are determining elements for success, engagement and happiness within the workplace. Not many aspects of human experience are as powerful as the desire to be understood and to understand. Regardless of title, tenure or position, employees who voluntarily leave generally say it is because of some disconnect with leadership. People who are challenged, valued, engaged and recognised will stay and contribute, because money is not the major motivator to stay. Social scientists have found we are born to interrelate and humans have a dedicated neurobiological system that is responsive to social bonds and fosters other-interested feelings and behaviours. Care and compassion are not separate from being professional or doing the work of the organisation but are a natural and living representation of people's humanity in the workplace.

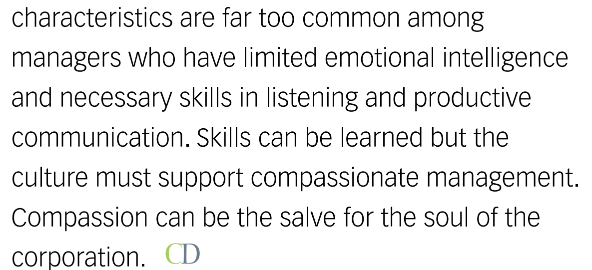
"Not many aspects of human experience are as powerful as the desire to be understood and to understand."

Traditional approaches to management haven't changed significantly in the last few decades. We often treat workers like a commodity and attempt to get as much from them as possible with an eye locked on the bottom line. Leadership wants critical thinkers, collaboration and creativity, and

people want to grow in their role, feel fulfilled and appreciated.

Compassion in the workplace is essential for durable, satisfying and rewarding relationships. It can be achieved through constructive communication, understanding and respectful interactions. A policy that states we must be respectful of others, not bully, and treat colleagues with dignity is only a piece of paper if it is not practiced. People naturally engage in conflict and this is productive if it leads to something better like understanding, guidance, insight or explained expectations.

When conflict is not properly managed it causes discomfort, becomes chronic and interferes with performance. This destructive pattern impedes our reasons for being here, diminishes relationships and causes disengagement. These negative characteristics are far too common among managers who have limited emotional intelligence and necessary skills in listening and productive communication. Skills can be learned but the culture must support compassionate management. Compassion can be the salve for the soul of the corporation. CD



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PERSPECTIVES

A PERFECT STORM – WHY CLASS ACTIONS WILL SOON BE COMING TO A UK COURT NEAR YOU

BY **JOHN P BROWN AND BRANDON KAIN**
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A perfect storm is brewing in the United Kingdom.

The European Commission recently recommended that Member States consider implementing collective redress regimes. For several years, courts in the United States have been severely restricting the ability of foreign claimants to participate in US class actions leading to a proliferation of US class action law firms seeking relief on behalf of UK claimants in London. In August 2015, a Canadian court refused to allow foreign claimants to participate in a Canadian class action.

Then, in October 2015 the UK parliament passed legislation allowing private 'class action' style proceedings. Thanks to this new legislation, UK claimants left homeless by the jurisdictional constraints imposed by US and Canadian courts can now return home to seek the class action relief that has eluded them in foreign courts.

The European Commission Recommendations

In June 2013 the European Commission published its policy paper on collective redress. Although the paper does not require Member States to

implement collective redress regimes, it contains proposals for addressing the violation of rights granted under European Union law including a non-binding Recommendation "on common principles for injunctive and compensatory collective redress mechanisms in Member States". The Recommendation proposes opt-in rather than opt-out collective redress (i.e., class action) regimes.

Jurisdiction and the UK Class Action Act

In October 2015, the UK parliament passed Schedule 8 of The Consumer Rights Act 2015, permitting private 'class action' style proceedings in competition matters (the 'UK Act').

Procedurally, the UK Act is modelled on the opt-out class action regimes in Canada and shares the same policy objectives – access to justice, judicial economy and behaviour modification. For sound legal and political reasons, the UK adopted an opt-out class action model for resident claimants notwithstanding the EU's recommendation of an opt-in model.

Jurisdictionally speaking, however, the UK Act takes a very different approach than most Canadian class action regimes when it comes to foreign claimants. Whereas, at least until recently, most Canadian class action regimes applied the same opt-out approach to foreign claimants as it did to resident claimants, the UK Act requires foreign claimants to 'opt-in' to a class. It is this evolving approach to jurisdiction over foreign claimants that portends a potential wave of competition class actions in the UK.

Under Canadian opt out class action legislation, the court certifies a defined class of people and/or entities who are then presumptively bound by a judgment in the action unless they take active steps to 'opt-out' of the proceedings. This legislated provision is uncontroversial when it is applied to resident claimants over whom the Canadian court has unquestioned jurisdiction. However, different considerations apply to foreign claimants who are not present in Canada, are not subject to the jurisdiction of a Canadian court and have never taken positive steps to consent to its jurisdiction. This is because pursuant to generally accepted principles of private international law, jurisdiction

"UK claimants left homeless by the jurisdictional constraints imposed by US and Canadian courts can now return home to seek the class action relief that has eluded them in foreign courts."

cannot be asserted over a foreign party for the purposes of a judgment that is intended to be enforceable outside of the 'state' issuing the judgment unless the foreign party was present in the 'state' when the proceedings were commenced, or submitted or consented to the jurisdiction of the 'state'.

Prior to 1990, Canadian courts applied the generally accepted principles of private international law in deciding whether to assert jurisdiction over foreign parties. This changed in 1990 when the Supreme Court of Canada adopted a new jurisdictional test, the 'real and substantial connection' test, which it later extended to international litigation in 2003. This test is a radical departure from the generally accepted principles of private international law adhered to by other countries for asserting jurisdiction for the purposes of a judgment that is intended to be enforceable internationally.

As a result, Canada will enforce foreign judgments in which jurisdiction has been asserted over a party to the proceeding based on a real and substantial connection. The same cannot be said for foreign countries. They do not accept the real and substantial connection test as a proper jurisdictional basis for enforcing a judgment from another country. Rather, foreign courts will only enforce a judgment from another country where the other country asserted jurisdiction over the parties based on the traditional grounds of presence, consent or submission. A foreign judgment pronounced on other jurisdictional grounds is considered a nullity and will not be enforced.

Notwithstanding the rejection by other countries of the real and substantial connection test for judgments that were intended to be enforceable internationally, until recently Canadian courts routinely certified classes that included foreign claimants using that jurisdictional test. When Canadian courts did so, they purported to assert jurisdiction over foreign claimants on a basis that would not be recognised by the countries in which the foreign claimants resided. This meant that the Canadian class action judgment would not be given preclusive effect in foreign courts and the issues that were the subject of that judgment could be re-litigated by foreign claimants in their 'home' countries. This result has been confirmed by courts and commentators worldwide.

This is a key reason the UK Act provides for an opt-out regime for resident claimants (because they are subject to the UK courts and corresponding legislation by virtue of their presence in the country) and an opt-in regime for foreign claimants. The opt-in proposal for foreign claimants was, according to the Civil Justice Council, "intended to avoid any arguments in relation to national sovereignty which might arise if the provisions purported to assert jurisdiction to decide cases for foreign domiciliaries who have taken no active part in the proceedings".

The UK – a new class action haven

The UK Act permits class actions in competition law matters. A classic competition law matter involves price-fixing conspiracies. Frequently, price-fixing conspiracies are international in scope and affect claimants in more than one country. This is why plaintiffs in US and Canadian class actions frequently sought to certify classes that included potential claimants from around the world, including from the UK.

However, in recent years this practice has been seriously restricted by US courts that refuse to certify worldwide classes.

Now Canadian courts have started to do the same. In August 2015, the decision in *Airia Brands Inc. et al v Air Canada et al* 2015 ONSC 5332 (CanLII) was released. In this Canadian class action, the plaintiffs alleged that the defendants conspired in Canada and throughout the world to fix prices of airfreight cargo shipping services for shipments to or from Canada and sought to certify a worldwide class that included foreign claimants. The Court refused to certify a worldwide class because it held it did not have jurisdiction over the proposed foreign claimants.

The UK Act has arrived at the perfect time now that US and Canadian courts are exercising proper jurisdictional constraint and closing their doors to

foreign claimants in class actions. Under the UK Act, UK claimants will no longer have to endure the cumbersome and ineffective procedures that plagued the action brought by the UK Consumer Association against JJB Sports (which had taken part in fixing the prices of some replica football shirts) and that are hampering the current multiple air cargo price fixing proceedings against British Airways. With US class action law firms already in London, with no comparable opt-out class actions in other European countries, and with the flexibility that the Brussels I Regulation offers potential claimants in other Member States to enforce UK judgments throughout the EU, the new UK class action will soon become the procedural vehicle of choice in Europe for consumer competition class action relief. CD

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PERSPECTIVES

REPORT ON THE FRENCH CLASS ACTION

BY **OZAN AKYUREK**
> JONES DAY

The French class action entered into force on 1 October 2014 as part of the Consumer law called 'the Hamon Act'. A tidal wave was expected for this long-awaited law. A year after its entry into force, the results are underwhelming. For the time being, only six class actions have been instituted before French courts, compared to the thousands brought each year before the US Courts. Several reasons may underline this limited number of class actions.

The limited scope of the French class action

The French class action targets only consumer victims; the consumer being defined as any natural person acting for purposes which fall outside of his trade, business, craft or profession. Therefore, businesses and professionals cannot gather together in order to start a class action.

"The French class action targets only consumer victims; the consumer being defined as any natural person acting for purposes which fall outside of his trade, business, craft or profession."

Remedies may only be sought for economic losses resulting from material damages suffered by consumers.

A monopoly of accredited consumer associations has been introduced for the defence of consumers. As of today, 15 consumer associations are entitled to act on behalf of consumers. Unlike the US system, the French class actions functions on an opt in with publicity basis, hence requiring a positive act on the part of the consumer willing to take part in the action.

The Consumer Law provides for a two-stage procedure: (i) a civil courts decision on the professional's liability; and (ii) a compensation stage allowing consumers to recover damages following the court's decision. This quite restrictive conception

of the class action could explain the reason why only six class actions have been introduced within the last year.

Only six class actions have been brought since the adoption of the Consumer Law

So far, various class actions have been brought before French courts by accredited consumer associations (UFC Que Choisir, SLC-CSF, CLCV, etc.). It is important to note that each case has had an impact on the image of the companies concerned by the class action, which led the said companies to set up internal committees to face the media coverage.

The French accredited consumer association UFC Que Choisir was the first consumer association to bring a class action. On 1 October 2014, UFC–Que Choisir filed a class action against FONCIA, a company specialised in residential property management and real estate services, on the same day class action lawsuits became legal in France.

UFC–Que Choisir summoned FONCIA to appear before the District Court of Nanterre on behalf of tenants over the allegedly illegal fees it charges renters. UFC–Que Choisir argues that FONCIA has collected €44m in illicit charges over the past five years, according to a press release issued by UFC–Que Choisir on 1 October 2014.

Toward the extension of the scope of French class action?

Labour law. The President François Hollande has called for an extension of the scope of class actions to labour law and more particularly to discrimination in companies and in access to employment. This wish was echoed by the Prime Minister and by a Ministry of Labor and Employment report dated 2 April 2015. The class action for discrimination could be effective as from 2016 since the Bill on 21st Century Justice, which is backed by Christine Taubira, the French Minister of Justice, was voted in first reading by the Senate on 5 November 2015.

Health. Following a bill proposal of 17 March 2015, the French class actions might be extended to personal injury claims against health products manufacturers, suppliers of service providers using health products. Using the same framework as the one on consumers, patients and users' associations will have the monopoly to bring class actions for damages for similarly situated users having suffered physical injuries. An issue for the judge will probably be to deal with the heterogeneity of patients' personal injuries.

Environment. Class actions on environmental issues were considered quite early but are not yet part of the legal framework. Permitting associations for the protection of the environment to represent individual victims for environmental damage before the courts could be beneficial, allowing compensation for individual victims for their personal damage (not only with regard to the collective interest) resulting from an offence against the environment. However, the purpose of such

class action does not entirely concur with the one existing for consumers, which is basically to seek remedies for mass damage where the harm caused to each consumer is minimal. On the contrary, environmental damages may be very important and affect a restricted number of persons.

Conclusion

The Ministry of the Economy is satisfied with the development, even though timorous, of the Consumer Law class action and greets the engagement of the associations. It highlights that this procedure is meant to ensure equilibrium in the relationship between consumers and professionals.

As from January 2016, the generalisation of the mediation mechanism to the consumer field will complete and reinforce the class action tool, the scope of which might also be extended to other fields. It appears that the class action mechanism is riding high in public opinion – the legislator just needs to follow up. CD

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PERSPECTIVES

SECURITIES CLASS ACTIONS IN CANADA: AN OPPORTUNITY TO REDUCE RISK FOR DIRECTORS AND OFFICERS

BY **NADIA CAMPION**
> LENCZNER SLAGHT

In Canada, securities legislation permits purchasers of securities in the secondary market to bring class action lawsuits against public companies, their directors and officers and others for alleged misrepresentations in financial statements and other public disclosure. Investors can do so without proving that they relied on the misrepresentation in making their investment decisions. However, as a result of a unique statutory safeguard in Canada designed to prevent unmeritorious lawsuits, investors must first obtain leave from the court to pursue their claims by demonstrating that: (i) their claims are brought in good faith; and (ii) there is a reasonable possibility that they will succeed at trial.

In addition to the leave requirement, various statutory defences are available to directors and officers, including the 'reasonable investigation' defence. That defence permits the defendant to prove that: (i) before the release of the public disclosure containing the alleged misrepresentation, he or she conducted a reasonable investigation;

and (ii) at the time of the release of the public disclosure, he or she had no reasonable grounds to believe that the document contained the alleged misrepresentation. To date, there have been a relatively limited number of cases where the courts have considered this defence at the preliminary leave stage. However, those cases suggest that directors and officers will be held to a high standard. They must show that they took diligent steps to ensure the accuracy of the company's statements before their disclosure to the public. The question is: what must a director or officer do to successfully invoke the reasonable investigation defence and defeat a class action at the initial stages of litigation?

The reasonable investigation defence was first considered in *Silver vs. IMAX Corporation*. There, the plaintiffs alleged that IMAX and its directors and officers misrepresented that the company's financial results were prepared in accordance with generally accepted accounting principles. In considering the reasonable investigation defence, the Court analysed the qualifications, knowledge and experience of each director and officer, as well as their respective roles and responsibilities regarding financial reporting and revenue recognition. It also reviewed the company's policies and procedures respecting its continuing disclosure obligations, the systems in place for financial reporting, including the performance of external audit functions, as well as the reasonableness of reliance placed by the directors and officers on those systems.

With the exception of two directors (who had no role in management or on the company's audit committee), the Court found that there was insufficient evidence to absolve the other directors and officers of liability at the preliminary stage of the litigation, particularly in circumstances where it appeared that the company's internal accounting processes were deficient. As a result, the Court allowed the plaintiffs to proceed with the class action lawsuit against not only the issuer, but also the directors and officers.

More recently, in *Rahimi vs. SouthGobi Resources Ltd*., the Court did not permit a proposed class action lawsuit to continue against two officers and three directors of a coal mining company. The class action was commenced shortly after the company announced a restatement of its consolidated financial statements to correct revenue recognition errors in its public disclosure. The directors and officers of the company argued that they conducted a reasonable investigation of the accuracy of the financial statements prior to the release of the alleged misrepresentations. The Court agreed.

The evidence filed by the defendants demonstrated that the two former chief financial officers (CFOs) named as defendants carefully analysed the company's financial information and criteria for revenue recognition, and relied upon the judgment of their colleagues in management, as well as the expert opinions of the company's auditors. They also sought and obtained the approval

of the company's audit committee and the board of directors prior to the release of the company's financial statements. The Court concluded that the former CFOs had no reasonable grounds to believe that the financial results contained in the company's public disclosure contained any misrepresentation regarding the company's revenue recognition.

With respect to the three directors, the Court accepted their evidence that "they did everything that could reasonably be expected of them as

members of the [company]'s board and audit committee", including reviewing audit opinions, analysing the reporting and recognition of revenue, and interacting with both management and the company's auditors in approving the company's financial statements. The directors also followed the appropriate corporate governance standards and the company's accounting procedures and internal controls.

The Court ultimately concluded that "nothing more could have been done by the two CFOs and the three directors to ensure the legitimacy and accuracy of the financial representations at issue". In the result, the Court determined that the directors and officers had successfully established the reasonable investigation defence and that there was no reasonable possibility that the plaintiff would succeed at trial in respect of the claims advanced against them. However, the Court also cautioned that establishing the reasonable investigation defence is "a relatively high hurdle for the defendants". If there is a reasonable possibility that the defendants will not be able to establish the defence at trial, the Court must grant leave to the plaintiffs to proceed with their class action lawsuit. The defendants are appealing the decision.

Directors and officers of public companies face significant exposure to securities class actions for secondary market misrepresentation, particularly where the company releases restated financial statements or other corrective disclosure. It is therefore important that they adopt and implement appropriate measures to establish a strong defence if a lawsuit is commenced.

"Although there will always be the risk of a lawsuit, the reasonable investigation defence provides directors and officers with the opportunity to eliminate their exposure at an early stage of securities class actions in Canada."

As a starting point, directors and officers must have a clear understanding of the company's public disclosure obligations and ensure that the company has appropriate controls in place to comply with such obligations, including a reliable process to support certification of the company's public disclosure. These processes should be periodically evaluated and well-documented so that there is a solid evidentiary record to substantiate the reasonable investigation defence.

Directors and officers should attend all board meetings and ensure that they understand the financial information that will be released to the

public. Full and complete briefing materials should be provided sufficiently in advance of meetings to enable proper review. Directors and officers should consider keeping detailed records of their decisions on significant issues within the company, particularly as it relates to how financial information is captured, summarised and reported. They should also know how and when to seek the advice of their auditors, lawyers and other professional advisers in carrying out the company's disclosure obligations, as well as in respect of fulfilling their own duties.

Finally, the investigation of misstatements in financial information released to the public should be carried out thoroughly and carefully. The manner in which such matters are characterised and disclosed can have a significant impact on potential liability. It is also important that the company puts appropriate document retention policies in place in order to ensure that evidence of reasonable investigation is available to the directors and officers in the event of a lawsuit.

Although there will always be the risk of a lawsuit, the reasonable investigation defence provides directors and officers with the opportunity to eliminate their exposure at an early stage of securities class actions in Canada. CD

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HOT TOPIC

SECURITIES CLASS ACTIONS IN THE UNITED STATES

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CD: Could you provide an overview of the current securities class actions landscape in the US? What levels of activity have you seen in the last 12 months or so?

Tuttle: After a small decline following the peak of the financial crisis cases, securities class actions seem to have returned to more normal levels, and there does not appear to be any signs that there have been any significant shifts in class action levels. The US Securities and Exchange Commission's renewed focus on accounting and financial reporting cases has, predictably, spurred greater focus in the area by companies, their auditors and investors, and, as a result, has triggered a number of securities class actions in the wake of disclosures of restatements, internal control issues or other accounting-related developments. Similarly, cases arising from cyber security breaches seem likely to add to the volume of class actions in coming years as more and more companies fall victim to attacks and more plaintiffs claim that the companies' risk and other disclosures around cyber security efforts are misleading.

Fumerton: Filing activity for securities class action litigation appears to have held steady over the past three years. We've seen predictions that the total number of new federal securities class actions filed in 2015 will be only slightly lower than the annual average of such filings seen in the years 2005 through 2014. One new trend that we've been seeing is that large shareholders, including major investment funds, are opting-out of securities class actions on a more frequent basis. One possible explanation for this trend is that it is a reaction to the Second Circuit's decision in *IndyMac*, which held that the two-year statute of repose in the Securities Act of 1933 cannot be tolled for absent class members by the commencement of a class action. We have also seen increased efforts by plaintiffs to file Securities Act claims in state court

"The initial public offering market appears to be heating up, and there have been a number of large merger and acquisition transactions announced over the past several years."

Brian Herman,
Morgan Lewis & Bockius LLP

in order to avoid many of the hurdles imposed by the Private Securities Litigation Reform Act.

Herman: From our perspective, the securities class action landscape remains very active, with levels of new filings on par with recent years. Each year, Cornerstone Research publishes a comprehensive analysis of class action filings, and their data for 2014 confirms that the number of federal securities class action filings remains relatively unchanged, with 170 new cases in 2014. State court securities class actions challenging merger and acquisition transactions – frequently filed in the Delaware Court of Chancery and focusing on alleged breaches of fiduciary duty – also remain extremely active. Indeed, nearly every M&A deal of any size is subject to litigation.

CD: What are some of the common factors driving today's securities class actions? Have any noteworthy cases surfaced?

Herman: The initial public offering market appears to be heating up, and there have been a number of large merger and acquisition transactions announced over the past several years. We hope this trend continues, but we recognise that, as the number of transactions increases, so too does the risk of litigation. In terms of noteworthy cases, we are paying heavy attention to a number of important cases in Delaware that could shift the landscape in M&A securities litigation. In the *KKR* case, the Delaware Supreme Court clarified that, if a merger is not subject to "entire fairness" review, and a majority of fully-informed, disinterested stockholders vote in favour of the transaction, the Court will apply the business judgment rule rather than 'enhanced scrutiny' under *Revlon* and its progeny. At the same time, the Chancery Court has issued a number of decisions indicating that the courts will no longer approve class action settlements with broad releases where the benefit to the class consists of enhanced disclosure. Up until recently, such settlements were routine. Finally, there has been a noticeable uptick in the filing of appraisal actions by stockholders – including entities set up solely for the purpose of 'appraisal arbitrage' – challenging transaction consideration. Time will tell whether these decisions and trends will result in fewer securities class action lawsuits, or just a shift in approaches by the plaintiffs' bar.

Tuttle: Accounting and financial reporting issues have always been prime targets for securities class action plaintiffs and appear poised to continue that historical pattern. Increasingly, however, plaintiffs with weak accounting-related claims are having success with claims of alleged misstatements concerning internal controls over financial reporting as almost any negative corporate event can be said

to have been caused by or to reveal weaknesses in internal controls. This can be the case even when an accounting or other reporting issue itself is not material, but the uncertainties it creates lead to a more significant decline in share price when it is announced. These claims are often paired with a theory that a defendant's alleged internal control weaknesses caused it to misrepresent the risk of a negative corporate event – for example, an adverse litigation result or a significant accident – and damaged the shareholder plaintiffs when the 'true' risk was revealed by the occurrence of the event.

Fumerton: Probably the most noteworthy securities litigation decision of 2015 was *Omnicare, Inc vs. Laborers District Council Construction Industry Pension Fund*. In that case, the Supreme Court held that an issuer may be liable for opinions in a registration statement under Section 11 of the Securities Act of 1933 if it does not genuinely hold the stated opinion or a fact offered in support of the opinion is itself materially false or misleading. The Supreme Court further held that an issuer may be liable for omitting material facts about an opinion if those facts 'conflict' with what a reasonable investor would understand the opinion statement conveyed regarding how the speaker formed the opinion. This decision affects the cost/benefit analysis for issuers in deciding whether, and to what extent, matters of opinion should be included in registration statements. If an issuer does decide to include such matters in a registration statement, it is critical to understand the litigation risks of doing so and take active steps to mitigate those risks.

CD: In your opinion, what has been the legacy impact of the *Halliburton vs. Erica John Fund* case? What lessons have been learned from the outcome of this case and disputes linked to the financial crisis?

Fumerton: When the Supreme Court accepted certiorari for a second time in *Halliburton*, many wondered whether the Court was prepared to do away with the 'fraud on the market' presumption of reliance, which would have made securities class actions impossible, or nearly impossible, to bring. In the end, the Court declined to do so but it did allow securities class action defendants to introduce evidence of lack of price impact at the class certification stage in order to rebut this presumption. The *Halliburton* Court also left certain issues open – for example, what this evidentiary rebuttal should look like or which party was to bear the burden of production and persuasion in this respect. Lower courts grappled with these issues in 2015 and there is a possibility that the *Halliburton* case could make its way to the Supreme Court for a third time to provide additional guidance. In electing to challenge price impact at the class

certification stage, defendants must weigh the risk of collateral damage going forward if the court grants certification – such as a hampered ability to use similar analysis on summary judgment to defeat reliance, materiality or loss causation, or in connection with settlement talks and mediation.

On the other hand, challenging price impact at the certification stage provides an avenue for defendants to obtain early appellate review under Rule 23(f).

Tuttle: Although significant for the proposition that the basic presumption of reliance can be rebutted by defendants at the class certification stage by showing that the alleged misrepresentation had no price impact, it still remains to be seen whether the *Halliburton* case will fundamentally alter the securities litigation landscape. The district court's recent decision in the case on remand from the Supreme Court gives some hope to defendants that it will, in fact, be possible to rebut the presumption and defeat reliance at the class certification stage. However, as erected by the Supreme Court and interpreted by the lower courts thus far, the barriers to such an outcome are high. For example, at the class certification stage, courts must assume as pled both the materiality of the alleged misrepresentations and the corrective nature of alleged corrective disclosures. Defendants can really only seek to rebut the presumption by meeting their burden to prove that the alleged misrepresentations had no price impact.

Herman: While the *Halliburton* decision was much more muted than some prognosticators predicted, it still provided hope that, in some circumstances, defendants would be able to knock out cases at the class certification stage with expert evidence demonstrating a lack of connection between an alleged misrepresentation and a price drop. To date, that really has not been borne out. More time and court decisions are needed to judge the legacy of *Halliburton* and, in the near term, the Eighth Circuit's review of the class certification order in the Best Buy litigation should provide some guidance.

CD: Are participation rates in securities settlements trending higher or lower, and what are the implications?

Fumerton: There is evidence to suggest that larger shareholders are opting-out of securities class actions more frequently, and data also suggests that the chance of opt-outs increases with the value of the class action. This can have significant implications for a defendant considering settlement, as individual opt-out actions can undermine the ability to secure a 'global peace' and requires the defendant to deal with multiple plaintiffs concerned with their own economic self-interest apart from that of the class.

Tuttle: We are not aware of any new trend in participation rates, but there is increased focused on these rates and their impact on settlement values. Given that historic participation rates have typically been significantly below 50 percent, defendants and insurance companies are increasingly pointing to these low participation rates in settlement negotiations as further reasons for discounting settlement values. This leads to

discounts from modelled plaintiff-style damages both for risks associated with the plaintiffs' ability to prove liability and damages and for the fact that, even if successful at trial, the actual out-of-pocket damages that defendants will pay are almost certainly significantly below the amounts modelled with a 100 percent participation rate.

CD: What general advice would you give companies defending against regulatory and federal securities class actions in the US? Are there any particular challenges that frequently arise?

Herman: Companies should keep calm and call their lawyer, followed by their insurance broker. Experienced counsel can help with crisis management and the preservation of data, two things that need to be addressed immediately. And as far as insurance, it is critical for companies to know what coverage they have and what limits may be in place, and to provide prompt notice. After that, companies should not make the situation worse, such as reflexively issuing categorical denials or speaking to the press without first conducting an investigation. The truth is, however, that every case is different. When facing regulatory investigations, there are often strong incentives to cooperate and sometimes companies may work collaboratively with regulators, particularly if it is in a heavily regulated industry. In the class action context, you don't get any points for cooperating with the plaintiffs.

Fumerton: To be sure, there is no one-size-fits-all approach to regulatory and federal securities class actions in the US, and hiring experienced outside counsel is critical. Challenges that frequently arise include whether and how to address confidential witness allegations, issues regarding alleged insider trading by corporate executives in advance of a purported corrective disclosure, and steps to ensure preservation of attorney-client communications while advancing an advice-of-counsel defence, among many others.

> **"We are not aware of any new trend in participation rates, but there is increased focused on these rates and their impact on settlement values."**
>
> *Jonathan Tuttle, Debevoise & Plimpton*

Tuttle: Companies defending securities class actions today should really adopt a two-prong strategy for evaluating and responding to the claims. On one hand, they need to mount an effective defence to the litigation, including filing as comprehensive a motion to dismiss as possible, investigating allegations purportedly made by confidential witnesses, and preparing to manage the significant discovery that accompanies these cases. On the other hand, because most of these cases settle, companies must start the process of evaluating the potential settlement value of the case, discussing settlement issues with their D&O insurance carriers, and assessing plaintiffs' likely views on the case. It is important to pursue both of these paths in parallel because they each have an effect on a company's ability to effectively purse the other.

CD: In broad terms, how should parties go about assessing potential damages and evaluating the merits of a settlement?

Tuttle: Assessment of potential damages in a securities class action really requires the services of an experienced economic consultant. Because damages arise from the purchase of securities when allegedly misleading information causes the price to be inflated, a useful estimate of potential damages exposure depends on economic modelling of those share purchases, resulting turnover in the purchased shares, and the amount of alleged inflation present in the shares at different points in the alleged class period. Although these models can provide useful information on potential exposures, defendants must keep in mind that they do not provide actual

damages estimates because the true purchases, sales and participation rates cannot be determined until after trial.

Fumerton: Generally speaking, we find that it is often helpful to enlist expert consultants to assess potential damages in the securities class action context. There are a number of ways in which trading and price data can be used to parse a securities plaintiff's claimed damages and attempt to arrive at a reliable assessment of exposure. Additionally, experts can create event studies designed to disaggregate the impact of adverse information on stock price that is unrelated to the plaintiffs' alleged fraud. This not only gives the defendant a better view of potential liability but can also arm defence counsel with effective weapons to use in settlement negotiations and at mediation.

Herman: Information is critical to making an informed decision, and the more you know, the better. Sometimes, clients ask for an assessment early on, and it can be difficult to know whether the client faces significant damages without first understanding the liability exposure. In terms of sizing the case, we frequently work with experts to analyse potential damages. Sometimes, we will work with two experts – one who we anticipate using as our trial expert and one who serves only as a consultant and whose work, prepared at the direction of counsel, is better shielded from discovery.

CD: To what extent is technology playing a part in how securities class actions are conducted? To what extent can parties benefit from time and cost efficiencies?

Herman: One of the biggest issues we face is the ever increasing amount of data that needs to be preserved and reviewed for production. We rely on technology and our data experts for critical tasks, such as preserving email, instant messages, chats, voicemails, call recordings, and so on, helping provide an early assessment of the merits of a case, giving insight into data to allow for more effective negotiations with respect to scope of discovery, and using predictive coding and technology-assisted review to identify responsive documents.

Tuttle: The most significant development that we see in the conduct of securities class actions is the development and acceptance of improved electronic discovery processes, such as predictive coding and other document search and review tools. These technological tools enable parties, particularly defendants, to more efficiently process the vast amounts of electronic data now being sought in discovery, potentially lowering the cost and the burdens of document discovery. Reducing the costs and burdens of discovery potentially removes one element of leverage that plaintiffs have in pursuit of early settlements.

Fumerton: One significant advancement has been the rise in the use of document analytics in the context of e-discovery. Investigations and litigations can involve huge amounts of documentation, and predictive coding has been gaining increased acceptance as a viable way to identify relevant documents with less manual review. This can significantly decrease document review-related time and costs. Similarly, parties can now employ computer algorithms to classify and map large document universes in order to reveal patterns that may not necessarily be apparent based on a manual review. In fact, several courts have recently concluded that predictive coding is generally more effective than keyword searches in appropriate cases. We expect these new methods to continue to gain more and more acceptance by courts and litigants.

"Alternative dispute resolution techniques have always played a large role in resolving securities class actions, and we expect that trend to continue into the future."

Robert A. Fumerton,
Skadden, Arps, Slate, Meagher & Flom LLP

CD: Are you seeing alternative dispute resolution techniques being applied more often to resolve securities class actions?

Tuttle: Over the past 10 years, alternative dispute resolution has become a more prominent part of the resolution of securities class actions. Whether court-ordered or voluntary, mediation, in particular, is now a routine development and is often a tremendous help to both sides in assessing case values and findings ways to resolve more difficult cases. The tactics and strategies of mediators tend to differ between mediators and from case to case, but we have seen the market develop to the place where mediation is a common and expected development and something that defence counsel must plan and prepare for early in the case.

Fumerton: Alternative dispute resolution techniques have always played a large role in resolving securities class actions, and we expect that trend to continue into the future. While such techniques are not right for every case, a good mediator can regularly break through stalemates that may be impeding a reasonable resolution. Mediation is also often a helpful vehicle for assessing one's own case weaknesses without the downside of a binding judicial determination.

Herman: Mediation has been an important tool in resolving class actions for a long time, and we continue to see it as a very valuable approach. A competent mediator will bring in all parties, including the insurers who are often critical to any settlement.

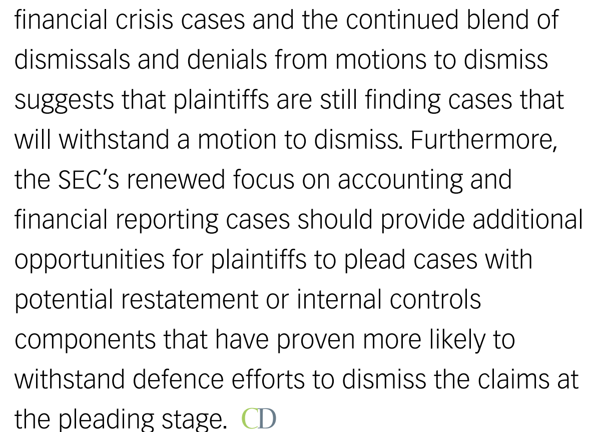
CD: Do you expect to see the number of US securities class actions increase over the next 12 months? What developments are likely to have an impact in this area?

Fumerton: We may see a general decrease in credit crisis-related securities litigation, as we have reached or are reaching the end of the statute of limitations for many such claims. In its place, we may continue to see increases in benchmark-related manipulation claims – for example, FOREX, LIBOR, US Treasury securities – and securities fraud claims regarding trend disclosure under Regulation S-K, Item 303. Additionally, recent increases in market volatility and declines in the energy sector may lead to more securities litigation activity as well. Separately, following the Supreme Court's decision in *Omnicare*, we may also see more opinion-based allegations by plaintiffs asserting securities claims.

Herman: Filings will stay stable or increase, but I am of two minds as to why that is likely to occur. One possibility is that the IPO and M&A markets

continue to heat up, and class actions tend to follow offerings and mergers. The second possibility is that the uncertainty of the world security situation, market turmoil in China, the elections or some other external factor will lead to a market correction here. When stock prices fall, class actions tend to follow.

Tuttle: We do not believe there is likely to be any significant departure from normalised levels of securities class actions in the near future. The return to these levels after the passing of the



financial crisis cases and the continued blend of dismissals and denials from motions to dismiss suggests that plaintiffs are still finding cases that will withstand a motion to dismiss. Furthermore, the SEC's renewed focus on accounting and financial reporting cases should provide additional opportunities for plaintiffs to plead cases with potential restatement or internal controls components that have proven more likely to withstand defence efforts to dismiss the claims at the pleading stage. CD

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AMERICAN ARBITRATION ASSOCIATION®

ORGANISATION

Association for International Arbitration

The **Association for International Arbitration (AIA)** is a non-profit organisation open to all those interested in ADR, irrespective of nationality and level of experience. Since its creation in 2001, AIA strives to bring together the global community in the field of ADR. However, AIA is not an arbitration institute and does not administer arbitration proceedings.

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ORGANISATION

CEDR

CEDR is a professional services consultancy which provides access to expertise in a range of commercial problem solving disciplines used to achieve resolution of conflict in business. Our Disputes Group handled more than 6000 disputes in 2013 and offers the services of mediators and skilled expert neutrals worldwide. CEDR offers leading expertise in consultancy, mediation training, and coaching, including the leading internationally recognised Mediator Skills Training program and the increasingly popular CEDR Certificate in Advanced Negotiation. CEDR's foundation activity leads ground-breaking research in conflict management, driving down the cost and impact of disputes on business.

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ORGANISATION

University of Missouri

The **Center for the Study of Dispute Resolution at the University of Missouri School of Law** develops and promotes appropriate methods for managing domestic and international conflict and enhancing informed decisionmaking. It does so through legal and interdisciplinary scholarship, law school teaching and curriculum initiatives, educational services to legal and other dispute resolution professionals, law reform related to dispute resolution, and direct dispute resolution services. For more information, see law.missouri.edu/csdr/about.html.

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ORGANISATION

Chartered Institute of Arbitrators

The **Chartered Institute of Arbitrators (CIArb)** is a leading professional membership organisation representing the interests of alternative dispute practitioners worldwide. With over 14,000 members located in more than 130 countries, CIArb supports the global promotion, facilitation and development of all forms of private dispute resolution. As a not-for-profit, UK registered charity, CIArb works in the public interest through an international network of 37 branches. In addition to providing education and training for arbitrators, mediators and adjudicators, CIArb acts as an international centre for practitioners, policy makers, academics and those in business concerned with the cost-effective and early settlement of disputes.

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ORGANISATION

International Center for Compassionate Organizations

The **International Center for Compassionate Organizations (ICCO)** works to foster cultures of compassion in government, business, healthcare systems, service agencies, colleges and universities, schools, faith groups and other organisations worldwide. The ICCO responds to the emerging trend among a broad range of organisations seeking to incorporate compassion as a value and practice in their relationships with their staff, colleagues, board members, customers and communities. The ICCO develops practical research, resources, education, consulting, coaching and conferences. It takes a nonpolitical, evidence-based and public health approach, and assists organisations to effectively improve employee engagement, productivity, staff retention, profitability and customer satisfaction.

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ORGANISATION

New York International Arbitration Center

The **New York International Arbitration Center (NYIAC)** is a nonprofit organisation formed to advance, strengthen and promote the conduct of international arbitration in New York. NYIAC has three core functions: it offers world-class hearing rooms, breakout rooms and state-of-the-art technology for international arbitration of any size, including large, multi-party arbitrations, mediations and conferences; it develops programmes and materials about international arbitration in New York, the application of New York law in international arbitration, and the recognition, enforcement and implementation in New York of arbitral awards; and it supports dialogue, discussion and debate to keep New York at the forefront of international arbitration among the legal, judicial, academic and business communities. NYIAC does not administer arbitrations or publish arbitration rules.

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corporate disputes