PROSKAUER ROSE LLP

Proskauer on International Litigation and Arbitration:

2008 Trends and Developments in International Legal Practice

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I. Editors' Introduction

A. Members of Proskauer's International Practice Group have collaborated on this interdisciplinary 2008 Trends Report, which identifies and analyzes a number of the most significant legal issues that global businesses currently face. This Report focuses on the practical implications of these trends as well as the best practices for dealing with them to leverage opportunities in a fiercely competitive global marketplace.

B. We will be following and reporting more on these Trends throughout 2008 in our e-Guide, Proskauer on International Litigation and Arbitration (http://www.proskauerguide.com).

C. As with the e-Guide itself, our focus is on:

1. Companies or businesses with property (real, intangible, intellectual) or businesses affecting different countries;

2. Disputes or deals implicating the laws, legal practices, or regulatory regimes of different international jurisdictions; and/or

3. Disputes or deals where different possible international venues are available to pursue, defend, and resolve the disputes.

D. The accelerating pace and increasing complexity in each of the three major areas of international practice – international litigation and its alternatives; regulatory and investigative proceedings; and transactional and corporate practice – demand constant vigilance by clients and other companies in the international marketplace. We track these trends and developments and will continue to offer our observations to our clients and interested practitioners so that businesses can prepare themselves, adapt, and avail themselves of appropriate competitive opportunities.

E. As an overview to the 2008 Trends, we predict significant activity in each of the following areas:

1. Avoiding or managing international litigation or other regulatory or dispute resolution proceedings;

2. Structuring legal relations within and between businesses operating in the international sphere; and

3. Drafting of documents and other legal instruments to take account of the international aspect of clients' businesses and of the risks and pitfalls facing those businesses.

F. More particularly, we see the following occurring in 2008:

1. Increased litigation in the United States of international controversies.

2. Increased use of alternative dispute resolution techniques, other than in-court litigation and other than international arbitration.

3. Increased risks to international companies of simultaneous, coordinated regulatory or enforcement proceedings in multiple countries.

4. The continued (albeit lamented) "Americanization" of non-US legal systems, including

(a) The advent of collective litigation (class actions) in Europe, and

(b) Proposed reforms to civil law on remedies available to civil litigants.

5. The ramifications of the subprime mortgage crisis and accompanying credit crunch in the context of trends in MAC and related clauses – drafting, enforcement, and dispute resolution.

G. How should companies react to these Trends? There are several ways for clients and other interested businesses to stay ahead of the curve. For example, careful analysis of the nuances will show that some of these Trends are in apparent, but not real, tension. There are better and in some cases best practices with respect to creating controls within businesses, avoiding the problems altogether by proper forethought and foresight, managing the matters when they arise – in short, by creating not merely effective defensive positions that will help their business avoid the costs and risks of the issues being addressed but will actually affirmatively help their businesses compete and improve.

H. These and other important trends, and the concrete specifics of how to deal with them both defensively and affirmatively, will be addressed in several ways by the Proskauer International Practice Group in 2008, including:

1. Forthcoming updates to the e-Guide (http://www.proskauerguide.com);

2. Webinars following the same successful format as the 2007 Proskauer International Practice Group webinars; and

3. Our conference on Major Trends 2008, being held in Paris in Spring 2008 and in other major cities throughout the year.

I. We wish all our clients and friends a prosperous new year.

January 7, 2008
Louis M. Solomon
Jennifer R. Scullion

II. The Most Significant Trends Identified By Proskauer's International Practice Group:

A. Increased litigation of international controversies in the United States

By Louis M. Solomon

1. Overview:

   (a) In the last five years, there has been an increase in attempts by parties operating in the international sphere to gain access to US courts to resolve disputes. Despite some noteworthy developments to the contrary discussed below, we forecast that this trend will continue, particularly in relation to forum-related issues (such as personal and subject matter jurisdiction and venue), choice of law, and enforcement of awards or judgments.

   (b) We believe it is imperative that companies operating internationally consider the complex issues of simultaneously managing litigation in the US and elsewhere, including issues of privilege, evidence-gathering and taking, and going to trial in the US.

   (c) As recent developments in the US confirm, a keen eye must be placed on drafting operative legal documents and litigating disputes in a way that will enhance such companies' ability to enforce awards and judgments and avoid efforts by adversaries to enforce inappropriate awards and judgments.

2. Analysis

   (a) Extending US jurisdiction – personal jurisdiction

      (i) Although this phenomenon will be seen with greatest clarity in connection with regulatory investigations and proceedings, discussed below, predictable increases will continue at the margins of personal jurisdiction and venue.

      (ii) One example of this is the decision of the federal District Court in New York, *Mones v. Commercial Bank of Kuwait*, 502 F.Supp.2d 363 (S.D.N.Y. 2007). There, Judge Scheindlin addressed two issues, one relating to service of process and one relating to the expansion of New York's long arm jurisdiction statute, which relates to personal jurisdiction. On the first issue, the Court determined that service of process was insufficient because Kuwait had successfully opted out of particular service provisions of the Hague Convention.

      (iii) On the issue of personal jurisdiction, the Mones Court made two significant rulings: First, that the time for testing amenability to suit was at the time of commencement of the suit, not the time the acts were performed, and not at the time the issue was adjudicated. Second, the Court addressed the case where a bank had not only determined to close its operations in New York long prior to the suit but was well along the way to effectuating its complete removal. That removal, however, was not done instantaneously (nor could it have been). At the time of suit, the bank "had stopped performing regular banking functions in New York and was in the process of unwinding its business". Nonetheless, because the bank was performing activities that were necessary for it to withdraw (going through the liquidation process) and for that purpose only maintained an

administrative office and paid its employees, the Court found that the bank's "contacts with New York at the time of service satisfy both the 'doing business' standard [under New York law] and the due process requirements [under the US Constitution] for laying jurisdiction in New York.

(iv) Important Practice Tips stemming from *Mones* will be addressed in forthcoming updates to the e-Guide.

(v) For a related indication of broadening reach of US jurisdiction, see the decision by the federal (US) Court of Appeals for the Second Circuit in *ITC Limited v. Punchgini*, (2d Cir Dkt. No. 165, dated Dec, 13, 2007. After receiving an answer to an important question from the highest court in New York state, the federal Circuit held that one who holds trademark rights outside the US can bring an action in the US for unfair competition under New York law against a defendant that uses the mark in New York for the same goods and services as the foreign trademark owner.

(vi) One significant exception to ever-expanding jurisdiction is exemplified by the important decisions rendered by the federal (US) Court of Appeals for the Second Circuit, in tandem with the highest state court in New York, the New York Court of Appeals. In *Ehrenfeld v. Mahfouz*, 489 F.3d 542 (2d Cir. 2007), the federal Circuit court took the fairly uncommon step of certifying a question to the New York Court of Appeals – *i.e.*, asking the Court of Appeals to rule on the legal issue. The question was whether defensive activity in New York – sending a single cease and desist letter into New York for a suit in England, sending suit papers into New York, following up on that process, and related activities – provided sufficient basis for personal jurisdiction in the US. The New York Court of Appeals answered the question in the negative and offered its usual concise and insightful analysis of the question of personal jurisdiction, especially in the context of non-US default judgments, which has significant implications. *Ehrenfeld v. Mahfouz*, 2007 N.Y. Slip Op. 09961, 2007 WL 4438940, (N.Y. Dec. 20, 2007).

(vii) The decision should be read together with another recent decision on personal jurisdiction from the New York Court of Appeals, *Fischbarg v. Doucet*, 2007 N.Y. Slip Op. 09962, 2007 WL 4438979 (N.Y. Dec. 20, 2007).

(b) Extending US jurisdiction – enforcement or resistance of non-US judgments. The decisions of 2007 point the way to the development of this trend in 2008:

(i) The US Court of Appeals for the Second Circuit handed down a significant decision in *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 500 F.3d 111 (2d Cir. 2007). There the Court upheld (as slightly modified) a "China Trade" injunction (*see* *China Trade & Development Corp. v. M.V. Choong Yong*, 837 F.2d 33 (2d Cir. 1987)), against a judgment debtor that barred the debtor from pursuing non-US litigation, even though the original judgment was not entered in the US and even though the US could only be considered a secondary jurisdiction under the New York Convention. The federal Circuit court reasoned that the additional court proceedings held by the federal District Court in New York, which was seized of jurisdiction because of a judgment-recognition proceeding in Texas (flowing from an original Swiss arbitral award), were enough to permit the federal court in New York to protect its judgment and enjoin proceedings in the Cayman Islands. A petition for review of this decision by the US Supreme Court is pending.

(ii) The Second Circuit's decision disagreed with a decision from another federal Circuit Court earlier in 2007, which held that, once satisfied, a judgment cannot form the basis for jurisdiction in a US federal court. *Goss Int'l Corp. v. Man Roland Druckmaschinen Aktiengesellschaft*, 491 F.3d 355 (8th Cir. 2007) (in the context of Japanese claw back statute). A petition for review of this decision by the US Supreme Court is pending.

(iii) There are many Practice Tips that derive from these decisions; they will be presented in e-Guide updates. These include the benefits of properly structuring the legal instrument forming the basis of a dispute, choosing the appropriate primary jurisdiction for the dispute, choosing the optimal court to enforce or resist an award or judgment, and where to seek an injunction pending resolution of the proceedings.

(c) Respecting non-US judgments in US proceedings.

(i) The Second Circuit Court of Appeals in *Sarl Louis Peraud Int'l v. Viewfinder, Inc.*, 489 F.3d 474 (2d Cir. 2007), vacated a judgment of the federal District Court in New York, which had refused to accord recognition to a French judgment on the ground that it was offensive to US free speech policy. The Circuit Court remanded the case to the District Court. If proceedings continue in the District Court, significant issues of public policy and US First Amendment bars to recognition of foreign judgments will be litigated.

(ii) Important developments in judgment recognition specifically and comity issues generally are likely to be seen in 2008 and beyond with the expected ratification of the Hague Convention on Choice of Court Agreements. When and how the US signs on to this convention will be key to US litigation in these areas.

(d) Discovery in the US for foreign proceedings.

(i) The most significant decision of 2007 points the direction for increased activity in 2008. In *In re Clerici*, 481 F.3d 1324 (11th Cir. 2007), the federal Court of Appeals for the Eleventh Circuit held that the federal District Court had authority under 28 USC. sec. 1782 to procure information regarding assets and property transfers of a US resident for use in *post-judgment* proceedings in Panama and that domestification of the non-US judgment was not a prerequisite for US court assistance. A petition for US Supreme Court review has been filed from this decision and is pending.

(e) Expanding discovery of non-US entities for purposes of US litigation.

(i) In *Strauss v. Credit Lyonnais*, 242 F.R.D. 199 (E.D.N.Y 2007), a federal Magistrate Judge directed discovery from the defendant non-US bank notwithstanding claims that the discovery was prohibited by French bank secrecy laws as well as by the French blocking statue.

(ii) Practice Tips from this decision will be treated in e-Guide updates. These include when and how most effectively must a non-US litigant in a US court raise reliance on non-US law.

B. Increased use of alternative dispute resolution techniques other than in-court litigation and international arbitration.

By Louis M. Solomon

1. Overview

   (a) With in-court litigation and arbitrations being seen as too costly and protracted, many clients are increasingly turning to other systems of dispute resolution. We see this on a large scale for disputes affecting large numbers of businesses or individuals. The rapid expansion of mediation techniques, staged claims procedures, and "rent-a-judge" programs will continue in 2008.

2. Analysis

   (a) The arbitration of international disputes continued in 2007, with oil and gas, telecom, and Russian Federation disputes leading the way. See Am Law Arbitration Survey (2007).

   (b) Noteworthy judicial cases arising from arbitrations also continue to fill out areas of the law that were previously unclear. See, for example, *Venture Global Eng., LLC v. Satyam Computer Serv.*, Ltd., 233 Fed. Appx. 517 (6th Cir. 2007) (enforcing London Ct. of Arb. award and rejecting objection under Indian law and *forum non conveniens*), and *Championsworld v. USSF and Major League Soccer*, 487 F.Supp.2d 980 (N.D. Ill. 2007) (enforcing arbitration provision in international soccer regulations; no conflict with US forum selection clause). Both cases were handled by Proskauer.

   (c) And there is an arbitration case before the US Supreme Court, *Hall Street Associates v. Mattel, Inc.*, No. 06-989, where the parties have been directed to file supplemental briefs addressing the following questions: (1) Does authority exist outside the Federal Arbitration Act (FAA) under which a party to litigation begun without reliance on the FAA may enforce a provision for judicial review of an arbitration award? (2) If such authority does exist, did the parties, in agreeing to arbitrate, rely in whole or part on that authority? (3) Has petitioner in the course of this litigation waived any reliance on authority outside the FAA for enforcing the judicial review provision of the parties' arbitration agreement?

   (d) However, what we see as a significant and growing trend, which we believe will continue in 2008, are modes of alternative dispute resolution other than judicial cases and standard arbitrations. These arise frequently because parties are in need of more cost effective and timely methods of resolving significant disputes.

      (i) For example, in a case handled by Proskauer, Merck AG and ImClone had a significant dispute over the next generation of cancer drug after Erbitux (the drug was called 11F-8). The agreement between the parties contained an arbitration provision, but the parties found themselves in need of emergency court intervention to appoint a replacement arbitrator. What then ensued is that the Court selected an arbitrator, a former federal appellate court judge (Hon. George Pratt), who ran an expedited, hybrid process – a hearing applying the rules of evidence with very few but some depositions but with full cross-examination at the trial. The parties were able to get the matter discovered, tried, and finally

resolved in a matter of months, at a fraction of the cost (in terms of dollars and time-delay) of a standard in-court case or a standard arbitration).

(ii) Timeliness of result was the driving factor in another recent example in an unprecedented, confidential ADR that occurred between a French governmental territory and a private entity (Bec) concerning extra costs and time delays relating to a public work (a museum in Lyon).

(iii) We are seeing many clients move in the direction of ADR proceedings, which may, for example, include mandatory mediation to resolve many of the claims before they get to a longer, larger, and more expensive forum. The courts will enforce conditions precedent requiring mediation. *E.g. B & O Manufacturing, Inc. v. Home Depot USA*., Inc., C 07-02864 JSW, 2007 WL 3232276 (N.D. Cal. Nov. 1, 2007) (dismissing claim for failure to mediate first). Careful drafting of such provisions is key, however, to their utility. *See, e.g., USA Flea Market, Inc. v. EVMC Real Estate Consultants, Inc.*, No. 07-11486, 2007 WL 2615887 (11th Cir. Sept. 12, 2007) (mediation provision would not survive termination of contract; ordering further proceedings on whether contract had been terminated).

(iv) In our experience, more informal yet inventive and effective ADR techniques are being used in the areas of telecoms, products liability, and construction. We are seeing staged claim procedures in a great many cases where a defendant is trying to resolve hundreds or thousands of claims in a rapid and even-handed way. We see this mode of dispute resolution blossoming in 2008.

C. The increased risk faced by international companies of simultaneous, coordinated regulatory or enforcement proceedings in multiple countries.

By Michael S. Lazaroff

1. Overview

(a) The Antitrust Division of the US Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC) continue to be very active in investigating and prosecuting alleged international antitrust and securities violations. The advent of multiple proceedings increases the risks to companies operating in international and global markets – a phenomenon equally prevalent for clients in the US, Europe and Asia.

(b) As of November 2007, for example, the DOJ reported that there were 56 sitting grand juries investigating suspected international cartel activity. This accounted for over 40 percent of the DOJ's ongoing grand jury investigations. Meanwhile, US regulators are increasingly working cooperatively with securities and antitrust authorities in numerous other jurisdictions and regulators outside the US are taking a more active role in investigating and punishing various anticompetitive behavior. The result is that international entities are facing more parallel investigations, cooperative investigations, and, in many cases, joint investigations by the DOJ or SEC and regulators in other jurisdictions. Likewise, US-based entities will likely have more than just the DOJ or SEC with which to contend.

(c) We predict that these efforts will intensify in the coming year, as will the phenomenon of follow-on private or class action litigation in the US and associated internal investigations based on the same allegations as the regulators are investigating.

2. Analysis

(a) For analysis of what is occurring in connection with SEC enforcement, please see the forthcoming update to the Proskauer e-Guide.

(b) For analysis of what is occurring specifically in Europe, please see the information on the upcoming IPG Major Trends Conference.

(c) General Trends in Antitrust and Competition:

(i) The US DOJ has been more aggressively investigating, prosecuting, and punishing international cartels that target US markets. Congress has substantially increased the maximum fines and sentences that can be imposed in the US for antitrust violations. The DOJ has been particularly successful in using its amnesty and leniency program to obtain cooperation from international companies.

(ii) In Fiscal Year 2007, the DOJ reports that it was successful in imposing prison sentences of 31,391 jail days for those violating the antitrust laws. Some non-US executives received jail sentences of up to 14 months. This is more jail days than were imposed in any other previous year. The DOJ also collected over $630 million in fines for criminal antitrust violations, including large fines imposed on British Airways and Korean Airways.

(iii) In 47 of the 56 instances in which the Division has secured a corporate fine of $10 million or greater, the corporate defendants were based outside the US.

(iv) Other countries have also either passed new anticompetition laws and policies or toughened their enforcement procedures to more effectively fight cartels using both civil and/or criminal sanctions. The Organisation for Economic Cooperation and Development (OECD) has recommended that governments consider imposing criminal sanctions against individuals to enhance deterrence and creating incentives to cooperate through leniency programs.

(v) The result is increased exposure for international companies and executives to severe fines and possibly prison sentences for anticompetitive conduct both in the US and in other countries.

(vi) DOJ claims that its recent success is the result of a number of factors including (i) its amnesty and leniency programs; (ii) greater cooperation and coordination with non-US competition authorities; (iii) punishing individual executives including non-US executives; and (iv) higher fines and longer prison sentences.

(vii) Increased presence of leniency programs in many jurisdictions and Increased coordination of leniency programs.

(viii) The DOJ has used its amnesty program successfully to obtain the cooperation of many companies. This program is among the DOJ's most successful sources for evidence against international cartels.

(ix) Numerous non-US authorities including the European Commission and Canada, are following the US example and either have implemented and/or are drafting and implementing leniency programs.

(x) This creates an increased possibility for companies to simultaneously seek and obtain amnesty and/or leniency in many jurisdictions at the same time.

(xi) It also exposes companies seeking leniency or amnesty in one jurisdiction to possible exposure from either governmental investigation or civil lawsuits in other jurisdictions.

(d) Plaintiffs in private litigation in US courts have had mixed success in trying to obtain discovery of confidential information submitted to jurisdictions outside the US.

(i) For example, in *In re Methionine*, Case No. C-99-3491 CRB (N.D. Cal. July 29, 2002), a federal court in California refused to force production of non-US leniency statements.

(ii) On the other hand, in *In re Vitamins Antitrust Litigation*, MDL No. 1285 (D.D.C. Dec. 18, 2002), it is reported that the federal court in Washington D.C. granted a motion to compel such a leniency statement.

(iii) Canada and the European Commission have intervened before US courts to attempt to convince them ***not*** to order such discovery.

(iv) Some non-US authorities will now take leniency statements as oral statements rather than as a written submission to avoid the potential discovery of these statements. Such steps do not necessarily resolve the potential exposure of this information to US discovery.

(e) Increased coordination by DOJ with other antitrust agencies in collecting evidence

(i) DOJ now reports that it regularly coordinates with other antitrust agencies in searching for evidence.

(ii) For example, in the investigation into illegal antitrust activity in the marine hose industry, searches were conducted by agents of the Defense Criminal Investigative Service of the Department of Defense's Office of Inspector General in the US and the UK's Office of Fair Trading, and the European Commission executed search warrants in Europe.

(iii) DOJ also exchanges information with other enforcement agencies where they are able to do so. For example, when they are able to obtain confidentiality waivers in cases of simultaneous leniency applications.

(iv) This general coordination is sometimes governed by formal bilateral agreements or mutual legal assistance treaties. Other times, the coordination is more informal and may occur through organizations such as OECD or the ICN.

(v) In several cases, countries were able to assist others in providing access to evidence and witnesses located in their jurisdictions.

(f) Increased enforcement of the antitrust laws against individual foreign executives.

(i) The DOJ has increased cooperation with foreign law enforcement authorities which they claim has given them greater success prosecuting individual foreign defendants.

(ii) Foreign defendants from at least Canada, France, Germany, Japan, South Korea, the Netherlands, Norway, Sweden, Switzerland, and the United Kingdom have been prosecuted for engaging in cartel activity, and these individuals have served, or are currently serving, prison sentences in US jails.

(iii) DOJ puts foreign witnesses and subjects of investigations on border watches to detect their entry in to the US.

(iv) DOJ also places fugitives on a Red Notice list maintained by Interpol which many countries recognize as a basis for a provision arrest leading towards extradition.

(v) Any foreign national therefore who does not appear in the US is likely to have a significant burden on the countries into which he/she can travel.

(vi) From a practical perspective, companies being investigated need to think about separate representation for their executives and balancing cooperation by a company with the impact on the individual executives.

(g) Extraterritorial Application of the US antitrust laws to foreign conduct

(i) There is still uncertainty in the US courts concerning the extraterritorial reach of US antitrust laws for conduct that is not considered to be independent of any domestic effect.

(ii) In *F. Hoffmann-La Roche Ltd. v. Empagran*, S.A., 542 US 155 (2004), *abrogating, Kruman v. Christie's Intern*. PLC, 284 F.3d 384 (2d Cir. 2002), the US Supreme Court held that where anticompetitive conduct significantly and adversely affects consumers both inside and outside the US, but the adverse foreign effect is ***independent*** of any adverse domestic effect, the domestic-injury exception under the Foreign Trade Antitrust Improvements Act of 1982, 15 USC. § 6a (the "FTAIA") does not apply; and, thus, neither does the Sherman Act.

(iii) The *Empagran* decision does not determine exactly when an international effect is considered independent of a domestic effect.

(iv) The *Empagran* Court instead remanded the question of whether the injuries were intertwined with a domestic effect because the availability of international arbitrage meant that foreign prices could not have been elevated without also elevating prices in the US.

(v) On remand, the Court of Appeals for the D.C. Circuit rejected this argument and concluded that, although the plaintiffs "paint[ed] a plausible scenario under which maintaining super-competitive prices in the United States might well have been a 'but for' cause of the appellants' foreign injury," such causation "between the domestic

effects and the foreign injury claim is simply not sufficient to bring anticompetitive conduct with the FTAIA exception." *Empagran v. F. Hoffman-Laroche Ltd.*, 417 F.3d 1267 (D.C. Cir. 2005). Rather, the Court held that the "statutory language – 'gives rise to' – indicates a direct causal relationship, that is, proximate causation, and is not satisfied by the mere but-for 'nexus' . . ." *Id*. at 1271.

(h) We see in a different case though that a motion to dismiss was denied by another US federal court, which held that claims that maintaining high prices in the US caused plaintiff's damages was sufficient to provide jurisdiction to a United States Court. *MM Global Services, Inc. et al. v. The Dow Chemical Co., et al*., 329 F.Supp. 2d 337 (D. Conn. 2004).

(i) Companies therefore still need to recognize that non-US plaintiffs may still be able to use the US Courts to recover treble damages if they can plausibly intertwine the international effect with the conduct in the US.

D. The continued (albeit lamented) "Americanization" of non-US legal systems.

By Christophe Lapp

1. Overview

(a) **The advent of collective litigation (class actions) in Europe.** Europe's legal framework is beginning to adopt the US approach to litigation of individual claims in a collective or class-based system. Even as the European Union considers measures to facilitate such lawsuits, the threat of cross-border litigation grows. The risk of these types of actions is most pronounced in the areas of product liability, competition, intellectual property, and shareholder rights/corporate governance.

(b) **Proposed reforms to civil law on remedies available to civil litigants. The reform of contract law in Europe is likely to continue.** One particular area of concern is in France, where a preliminary draft of reforms to civil remedies is being considered, among them the introduction of punitive damages. Should this become law, many other civil law jurisdictions, both in the EU and worldwide, will likely see fundamental changes in the manner in which lawsuits are brought, defended, and resolved.

2. Analysis

(a) **Collective Litigation (class actions)**

(i) **EU:** The Commission is pursuing a Consumer Strategy specifically aimed at increasing cross-border consumer/retail transactions, promoting consumer confidence in shopping freely across borders, whether on-line or traveling, and opening the consumer credit market within the Single Market. Initiatives announced last week by the Commission include a comprehensive overhaul of cross-border shopping rights and, in turn, an in-depth assessment of how best to strengthen consumer collective redress. Similar assessment of collective consumer actions in the anticompetition area also is expected.

(ii) **In France:** The past three years have seen considerable debate within France over the creation of consumer class actions. France is continuing in this direction. The key motivation is to permit collective recovery of otherwise small damages amounts. The current draft law has several significant restrictions:

- It applies solely to pecuniary/property damage and loss of enjoyment.
- Bodily injury is excluded and will remain within the scope of individual actions.
- The damage at issue must have originated in the failure to perform or the poor performance, by a professional, of contractual obligations resulting from a contract for the sale of a product or the provision of professional services.
- Damage that does not originate in the performance of a contract, such as environmental damage, is therefore not covered.

(b) **Changes in Civil Liabilities and Remedies**: France is examining a proposal for Contract Law Reform drafted by the "Catala Working Group." (French version; English version).

(i) **Punitive Damages:** The most important proposed innovation is the introduction of punitive damages where wrongful acts are "manifestly premeditated, particularly a fault whose purpose is monetary gain." (Article 1371) Recent comments suggest that France might reject this innovation, for now.

(ii) **Contracts:** As currently drafted, the proposal also would revise the French contract in several key ways, including:

- The creation of a "duty to inform" in the creation of a contract – a concept previously unknown in Civil law.
- The introduction of "imprévision," allowing parties to modify and renegotiate contracts in the event of material unforeseen circumstances. This may be provided for in the contract itself or may be sought by petition to the courts.

(iii) **Civil Liabilities:** The "Catala" proposal also suggests reforms to civil liability under the French Obligations Law.

- The classic distinction in Civil Law of extra-contractual duty and contractual responsibility is maintained.
- However, third parties may seek damages under principles of contractual responsibility.
- And there is consideration of new responsibilities altogether, including responsibility for abnormally dangerous activities.

E. Trends in US M&A – the subprime mortgage crisis and acquisition financing credit crunch have driven changes in deal terms and resulted in a spate of broken deals with accompanying renegotiations and litigations, especially concerning MAC clauses.

By Peter G. Samuels

1. Overview:

   (a) What is "market" for M&A deal terms, particularly for private equity buyers, has undergone marked change in recent years – driven first by an abundance of acquisition financing and the concomitant increased bargaining power of sellers, and most recently by turmoil in the credit markets and resulting paucity of acquisition financing, particularly for larger deals.

   (b) We believe that M&A deal terms will be increasingly "up for grabs" with no one able to convincingly assert that any particular set of closing conditions, walkaways for buyers, or deal protections for sellers is "market." Instead, we expect individual transactions to be negotiated on deal specific terms, with walkaways for the buyer and remedies for the seller dependent on bargaining power, perceived risks for buyers, and alternatives open to sellers.

   (c) In the meantime, broken deals will continue to work their way through the system – with many transactions being renegotiated through price reductions, alternative investments by buyers in target companies, and other restructurings. The spate of litigations where compromise eluded the parties will continue – shedding light on important but to date little litigated issues such as Material Adverse Change ("MAC") walkaways and the ability of sellers to force specific performance by buyers.

   (d) Except in places where these specific issues are regulated by rule or policy, no country will avoid these phenomena, in part because non-US deal lawyers look to experience in the US and because similar catalysts for the current state of affairs exists in those countries.

2. Analysis

   (a) To understand current trends – some background

      (i) Historically (and "history" in the world of M&A means going back all of three or four years), private equity was not a major player in the acquisition of public companies. The deals tended to be too big, the absence of indemnification was troubling, and most importantly strategic buyers (benefiting from lower cost of capital, the availability of stock as a tax-free acquisition currency, and operating synergies) often had a price advantage over private equity.

      (ii) The glut of acquisition financing (extraordinarily low interest rates, "covenant lite" loans, various PIK interest mechanisms, etc.) coupled with unprecedented sums of money flowing into the private equity funds themselves changed that dynamic. Private equity found itself able to compete on price with strategic buyers at the same time it suffered from an embarrassment of riches – more committed funds in its own coffers than it could deploy if limited to its historic mid-market, private target, sweet spot.

(iii) Where money flows, changes in deal terms often follow. Able to compete economically, private equity now found itself at a "deal term" disadvantage – the traditional PE acquisition model was to use shell acquisition vehicles, retain an express financing condition to closing, but provide comfort to sellers through financing commitments, an obligation to draw on those commitments, and a "reputational" argument – whatever the legalities, private equity could not afford to back out of deals because the result would be devastating to the "trust" potential sellers had that PE would live up to its M&A commitments.

(b) Emergence of the "reverse breakage fee," the credit crunch, and MAC clauses.

(i) As more money chased a limited pool of acquisition targets, sellers found themselves increasingly able to shift deal terms to (what they at least perceived as) the "pro-seller" side of the ledger. A big part of this shift was the emergence of the "reverse breakup fee" – a merger agreement provision which, stripped of its complications, promised the seller a termination fee (typically 2-3% of the purchase price – i.e., matching the breaking fee payable by the seller in the event of a topping bid) if the PE sponsor's financing fell through or the PE buyer defaulted in its obligation to close the acquisition. Seen by sellers (and their advisers) as a way of leveling the playing field with strategic buyers – sellers would now have a clear remedy if PE failed to close – reverse breakup fees were to have a wholly unexpected impact when the credit markets shifted during 2007, and, at least for larger deals, acquisition financing went from a flood to a highly uncertain trickle.

(ii) By mid-2007, many public acquisitions signed by PE buyers (and strategic buyers, as well), but not yet closed, looked for a variety of reasons (some connected, some not, to the turmoil in the credit markets) like bad bets. At the same time, the banks which had committed to finance these deals – unable to place their loans with other institutions, and in an interest rate environment that built in eight and nine figure losses if these banks were forced to fund – were desperate for an exit.

(iii) In the past, buyers faced with this prospect would have been forced to argue – in the absence of specific closing condition walkaways, which, in a generally pro seller environment, were relatively rare – the occurrence of a Material Adverse Change in order to extricate themselves from unwanted deals.

(iv) MAC clauses have historically been seen as pro-seller – even broad MAC provisions being interpreted, in the words of the leading Delaware case, "as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner." For a MAC to exist, the negative development must be unexpected, last a long time, and be of major importance to overall earnings. While there were few MAC decisions (and at least one recent decision, *Genesco v. Finish Line*, in the Tennessee Chancery Court, while ostensibly following Delaware precedent, appears to apply a less pro-seller general standard), buyers at risk for uncapped damages or even specific performance of their merger agreements were wary of litigating under the MAC standard. Even private equity, under the "old style" financing commitment plus obligation to draw on financings, felt at risk.

(v) Reverse breakup fees appear to have changed this dynamic. While a termination fee of 2-3% of a multi-billion dollar deal may be large in absolute

dollars, it often pales in comparison to the economic losses which could be suffered in closing a bad deal, and presents a radically reduced litigation risk compared to traditional sellers' remedies.

(c) Where are we now, and where are we going?

(i) The result has been the renegotiation of deals – reduced purchase price, alternative investments in the target by the private equity sponsors, and other restructurings – and a number of litigations – involving interpretation of MAC clauses, determination of whether reverse breakup fees represent the target's sole remedy, and other disputes.

(ii) In the meantime, deal terms seem to be completely unsettled. Our view is that they will remain so in 2008. With neither buyers nor sellers able to convincingly assert that any particular set of deal points "is market," recent reported transactions have involved both "pro-seller" and "pro-buyer" provisions which would have been previously unusual, e.g., specific EBITDA closing conditions, PE commitments to fund the full purchase price through its committed equity, and absence of damage caps or reverse breakup fees significantly higher than prior custom.

(iii) Finally, under their own rules and customs, deal terms in the UK and Europe seem largely unaffected by the US changes (though even there we do not think any unqualified predictions of status quo would be wise). Emanating from requirements of the UK Takeover Panel, and adopted in most of Europe, the requirement that bidders guarantee "certain funds" in public acquisitions, and limitations on "Material Adverse Change" walkaways, have meant that bidders in Europe need committed financing and cannot expect to rely on MAC walkaways in public company purchases. We predict that this will change, certainly in jurisdictions whose rules and practices are set more by free market forces.

(d) Lessons and Practice Tips

(i) With deals renegotiated and decisions handed down in litigations on a continuing basis, final lessons remain distant. But some messages are clear – *nothing* in buyer walkaways or seller deal protection is "market" today. Each deal needs to be evaluated and negotiated on its own terms.

(ii) If a buyer expects to be able to walk away based on a temporary decline in economic performance by the target, the merger agreement needs to say so. Similarly, the papers need to be clear if the seller expects to be able to "specifically enforce" a buyer's obligation to close a merger.

(iii) A surprising number of multi-billion dollar merger agreements have proved to be ambiguous or contain at least arguably contradictory terms. Not always unintentional (experienced deal lawyers know that ambiguity can be a tool – finessing an issue where the other side has the bargaining power, or necessary just to get the deal done); nonetheless, it is also sometimes plain that provisions which corporate lawyers thought were clear were viewed by litigators and ultimately the courts as open to multiple interpretations.

(iv) The "back of the merger agreement" – mundane provisions such as governing law and choice of court – is always important when disputes arise. Litigating the

merger agreement in Delaware, while the financing is litigated in New York (a not uncommon result of standard jurisdictional provisions), can have a major impact on outcome, as can the choice of whether a case is litigated in Delaware (which sees a constant stream of complex M&A cases) or a jurisdiction with less experience in these areas.

(v) These differences can be even more profound if the laws or procedures of different countries are used.

(vi) Other important Practice Tips concerning these phenomena will be addressed in forthcoming updates to the e-Guide.