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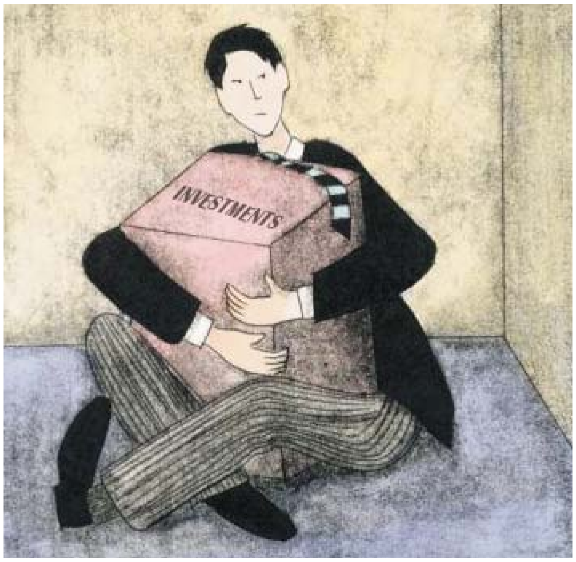
REGULATORY NEWS AND CASE UPDATES FROM BROWN RUDNICK'S EUROPEAN LITIGATION PRACTICE

RESTRUCTURING FOR PROTECTION?

Investors throughout the world are increasingly restructuring their investment vehicles in states that have signed investment treaties with the host states for their investments. This is because investment treaties grant the investors protection against the expropriation of assets without full compensation, as well as against non-equitable and unfair non-transparent judicial and legislative treatment at the hands of the host state.



Although the best course for an investor is to always plan for investment-treaty protection at the outset, the recent decision on jurisdiction in *Mobil Corporation et al v Bolivarian Republic of Venezuela* (ICSID Case No. Arb/07/27) has provided helpful guidance on how and when companies may restructure their investments to gain access to the protection they are seeking.

By way of background, Mobil Corporation first invested in two oil-field projects in Venezuela in 1996 and 1997. A few years later, in 2004-2006 the Venezuelan authorities unilaterally altered the regime applicable to the projects. As a result of these developments, Mobil decided to restructure its investments in the Netherlands, so as to ensure that it would qualify for protection under the Netherlands-Venezuela bilateral investment treaty ("BIT"). As a result, Venezuela Holdings BV, a Mobil subsidiary incorporated in the Netherlands, took ownership of Mobil's Venezuelan investments.

The relevant authorities in Venezuela were made aware of this restructuring but nevertheless continued to impose measures that harmed Mobil's investments. This eventually led to the expropriation of Mobil's two projects in June 2007.

Mobil, Venezuela Holdings BV and several subsidiaries filed an ICSID arbitration against Venezuela under the terms of the BIT.

Venezuela's leading argument was that the Tribunal lacked jurisdiction on the basis that Mobil's Dutch entity amounted to a "corporation of convenience" and that its corporate restructuring was an 'abuse of right'. The arbitrators dismissed this argument and held instead that

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restructuring for the primary purpose of accessing treaty protection was legitimate corporate planning, because it was designed to protect against future adverse Venezuelan measures.

In addition, Venezuela contended that the Arbitral Tribunal did not have jurisdiction, because **(i)** the investments were not direct and **(ii)** Venezuela Holdings BV did not have sufficient control over the subsidiaries that invested directly in Venezuela for the purposes of the BIT. The Tribunal dismissed both of these arguments. In relation to the first point, the Tribunal held that the BIT does not require that there be no interposed companies between the ultimate owner of the company or the joint venture and the investment and that a literal reading of the BIT does not support the allegation that the definition of investment excludes indirect investments. On the second point, the Tribunal ruled the test of control was simply the one of having majority ownership.

"The relevant authorities in Venezuela were made aware of this restructuring but nevertheless continued to impose measures that harmed Mobil's investments. This resulted in the expropriation of Mobil's two projects in June 2007."

The Tribunal's confirmation that, subject to the terms of the relevant investment treaty, restructuring for the primary purpose of accessing treaty protection is perfectly valid, is certainly encouraging for investors that may face difficulties in the state hosting their investments in the future. Encouraging as it may be, however, where possible, it is still best to invest in accordance with treaty protections from the very beginning.

HOW RULING IN *WESTFORD SPECIAL SITUATIONS FUND LTD V BAREFIELD NOMINEES LIMITED* MAY AFFECT INTERNATIONAL FUNDS' LITIGATION

On 22 September 2010, the Eastern Caribbean Court of Appeal set aside the winding up order made in the case of *Westford Special Situations Fund Ltd v Barefield Nominees Limited*, and dismissed the Joint Liquidators that had been appointed over the Fund.

Westford had been put into liquidation earlier in the year by shareholders whose winding up application had been based on their entitlement to unpaid redemption proceeds. The matter was heard at first instance by the courts of the BVI which had held that where a Westford feeder fund had elected to redeem an investor in specie it must provide quantifiable assets and that a share in the Westford master fund would not be adequate.

The court held at first instance that, as members with claims based on redemption proceeds, the shareholders were to be classed as creditors. They therefore had the requisite standing to bring an application to wind up the company and were not barred from doing so by BVI insolvency law. In addition, the court determined that the attempted in specie payment by Westford pursuant to its Memorandum and Articles was in fact impermissible.

Westford appealed contending that the court had erred in its findings, and the Court of Appeal upheld the appeal, dismissing the Joint Liquidators. Although the full judgment is yet to be published, as it stands the decision has potentially wide-reaching implications for all funds considering the form of its redemption payments, and may shed further light on the creditor/investor debate currently ongoing in much international funds' litigation.

BRIBERY ACT 2010: COMPANIES LEFT IN THE DARK?

In September this year the Ministry of Justice published its consultation paper on the Guidance to be issued on what will constitute "adequate procedures" that commercial organisations can put in place so as to ensure that they have a defence to the new controversial offence of failure to prevent bribery introduced by the Bribery Act 2010 (which is due to come into force in April 2011). The consultation period on the draft Guidance ran until 8 November 2010. The government expects to publish the final Guidance in early 2011.

The Guidance rests on six fundamental principles, namely:

1) risk assessment;
2) top-level commitment;
3) due diligence;
4) clear, practical and accessible policies and procedures;
5) effective implementation; and
6) monitoring and review.

The risk assessment principle provides that companies must regularly and comprehensively assess the nature and extent of the risks relating to bribery to which it is exposed. This assessment should be repeated periodically. It is directly linked with the third principle, which urges companies to introduce due diligence policies and procedures that would cover all parties to a business relationship, including the organisation's supply chain, agents, intermediaries, all forms of joint venture and similar relationships and all markets in which the company does business. The requirement of top-level commitment is designed to ensure a zero tolerance attitude towards bribery on the post of management.

The fourth principle encourages companies to ensure that their policies and procedures are clear, practical, accessible and enforceable. They should also be effectively implemented throughout the organisation to ensure that the development of policies and procedures reflects the practical business issues that companies' management and workforce face when seeking to conduct business without bribery (fifth principle). Finally, the Guidance provides that companies should institute monitoring and review mechanisms to ensure compliance with relevant policies and procedures, so as to ensure that improvements are implemented where appropriate.

The Ministry of Justice points out that the principles do not propose any particular procedures in themselves, but are instead intended to be used as a flexible guide to deciding what procedures are right for the organisation. As a result, it feels that there is still a substantial lack of certainty in what would actually constitute "adequate procedures." The Guidance itself states that whether a particular company's procedures are adequate will be determined in the context of a prosecution, taking account of the circumstances in which the relevant act of bribery took place. In that context, the breadth of the six principles may be seen as being of assistance to the prosecutor rather than the organisation under investigation. An oddity is, however, that an organisation is still likely to need to show that it has taken account of the six principles in developing, implementing, monitoring and reviewing its anti-bribery policies and procedures and although the draft Guidance provides flexibility for a company to tailor its policies and procedures to its business, the degree of this flexibility is, in fact, very limited.

The level of abstraction in the draft Guidance makes it difficult for any business – small, medium or large – to achieve certainty over what might constitute "adequate procedures". Perhaps this degree of uncertainty is, however, an intentional move that the Government has taken to ensure that companies behave in an overly careful manner. It certainly is a clever way to effect a change in behaviour in the business community and to ensure that internal controls and procedures are at the back of the mind of each and every company.

The publication of the draft Guidance for consultation represents another step towards the Bribery Act coming into force and there is no doubt about the fact that the tough new legislation and the Government's approach puts pressure on governments around the world to police the activities of corporations doing business in their countries and to consider the provisions that they currently have in place. The effect of this pressure on the international community is yet to be seen.

ELECTRONIC DISCLOSURE

NEW REGIME TO PREVENT PARTIES FROM SHORT-CIRCUITING THEIR OBLIGATIONS

On 1 October 2010 the 53rd update to the Civil Procedure Rules (CPR) came into force. Of particular interest to litigators and businesses are the new provisions, enshrined in PD31B of the CPR, relating to the disclosure of electronic documents in multi-track proceedings initiated in the High Court on or after 1 October 2010.

PD31B has been introduced to regulate the approach taken by practitioners when considering electronically stored material. Typically, costs incurred in relation to disclosure exercises account for approximately 30% of the overall cost of litigating a matter in England and Wales. PD31B seeks to reduce those costs by encouraging and assisting parties to litigation *"to reach agreement in relation to the disclosure of Electronic Documents in a proportionate and cost-effective manner"*.

Disclosure has been rendered more complex in the last 30 years by advances in modern technology. With the advent of the digital age, the majority of documentary evidence relevant to a case is likely to be held electronically on any number of devices from PCs to palmtops. The task of mastering IT infrastructures so as to be able to search for relevant documents is a daunting one, and perhaps explains why a number of parties to litigation have previously avoided following the Guidance on electronic disclosure that was set out under the old CPR in PD31 (now PD31A). Nonetheless, it has become clear that the courts are taking an increasingly tough line in relation to a party's failure to comply with its disclosure obligations; in the case of *Digicel v Cable & Wireless* [2008] EWHC 2522, Cable & Wireless was ordered to undertake its disclosure exercise for a second time at an estimated cost of £2m having failed to comply with their obligations the first time.

In keeping with the courts' approach, unlike the previous rules which were drafted in more tolerant terms, PD31B is prescriptive in its nature; parties will need to adopt a suitable approach to electronic disclosure in order to avoid facing unfavourable court orders or court sanctions.

The key requirements of PD31B are that:

1) Documents are to be preserved "as soon as litigation is contemplated" and it is incumbent upon legal representatives immediately to notify their clients of this obligation;

2) Parties are required to engage with one another at the outset of a case in order to discuss the electronic disclosure process. In fact, it is suggested that in certain matters those discussions should be held prior to the initiation of proceedings. In any event the parties must hold these discussions prior to the CMC and must consider and seek to agree matters such as: categories of documents; appropriate methods to be adopted so as to minimise costs of the process; and format of documents. Where matters cannot be agreed they must be referred to the court;

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3) Parties are expected to manage documents efficiently and where appropriate employ technology in order to ensure that document management activities are undertaken efficiently; and

4) Where appropriate the parties may exchange the Electrical Documents Questionnaire (the schedule to PD31B) detailing the scope, extent and suitable format for electronic disclosure. The questionnaire must be verified by a statement of truth.

Ultimately, whether the provisions of the new PD31B will be successful remains to be seen and will depend on how they are espoused by litigators and the judiciary; in light of their technical nature, there is a risk that rules will only be given cursory attention or that excessive costs will be incurred in seeking to comply with them.

Businesses who have a high risk of exposure to litigation may want to consider whether their current technology infrastructure is compliant with the evolving legal requirements. Well-maintained and accessible IT systems will not only dramatically reduce the burden of complying with electronic disclosure requests, but could also provide enhanced efficiency as well as an important strategic advantage.

RECENT CHANGES TO THE WITHOUT PREJUDICE RULE

The recent decision of the Supreme Court in *Oceanbulk Shipping v TMT* (2010 UKSC 44) (27 October 2010) saw a seven man bench reconsider the nature of without prejudice negotiations and the widely recognised exceptions to their privileged status. Although the Court's ruling, which overturned an earlier decision of the Court of Appeal, did not make any fundamental changes to the without prejudice rule it did clarify the extent of the existing exceptions and also introduced a new one- the interpretation exception.

The courts place a great deal of emphasis on the ability of parties to speak frankly and openly in settlement negotiations. As a result, with a few exceptions, the content of without prejudice communications (including oral negotiations and correspondence) are deemed inadmissible as evidence. The theory is that, as the parties know nothing they say can be relied upon in later proceedings, this fosters an atmosphere in which parties can talk freely in order to settle any differences between themselves, thereby avoiding the need to resort to costly and time consuming litigation.

To attract the protection that the without prejudice rule affords, the communications must be genuinely aimed at the settlement of a dispute. Simply labelling a letter or meeting without prejudice is not enough for it to be so and, likewise, the omission of such a label is not necessarily fatal to without prejudice protection provided the underlying purpose of the communications was the furtherance of a settlement.

"There are a few exceptions to the rule and these were set out with some authority in 1999 by Lord Justice Walker sitting in the Court of Appeal in the matter of Unilever v Proctor & Gamble (2000 1 WLR 2436)"

There are a few exceptions to the rule and these were set out with some authority in 1999 by Lord Justice Walker sitting in the Court of Appeal in the matter of *Unilever v Proctor & Gamble* (2000 1 WLR 2436). In that case the Court identified the eight exceptions where without prejudice discussions may be admissible:

1) Where there is a dispute as to whether without prejudice communications have resulted in a concluded settlement;

2) Where it is alleged that a settlement should be set aside on the grounds of misrepresentation, fraud or undue influence;

3) Even if there is no concluded settlement agreement, a clear statement which is made by one party, and on which the other party is intended to act and does in fact act, may be admissible as giving rise to an estoppel;

4) Where the exclusion of the statement would act as a cloak for perjury, blackmail or unambiguous impropriety;

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5) To explain delay or apparent acquiescence;

6) To establish mitigation of loss in the conduct and/or conclusion of a settlement;

7) Where there is an express saving, for example, without prejudice save as to costs; or

8) In matrimonial cases, there is a separate category of privilege where communications are received in confidence with a view to matrimonial conciliation.

In *Oceanbulk,* the Supreme Court endorsed these eight exceptions; recognised a ninth (the rectification exception) and added a tenth (the interpretation exception).

9) A party to without prejudice negotiations can rely upon anything said in the course of those negotiations in order to show that a settlement agreement should be rectified (the "rectification exception"); and

10) Facts communicated, which form part of the factual matrix and would (but for the without prejudice rule) be admissible as an aid to the construction of a settlement agreement that resulted from the negotiations, will be admissible by way of an exception to the rule because the agreement cannot otherwise be properly interpreted (the "interpretation exception").

It remains to be seen whether, as a result of this decision, parties will now be more cautious in without prejudice communications, and less prepared to make concessions or to say anything that might later be seen as prejudicing their position. If so, contrary to the Court's express wishes, this may well reduce the benefit of without prejudice discussions and make reaching settlements less likely. What the case certainly does is demonstrate the importance of ensuring that settlement agreements are drafted as clearly as possible, as ambiguities in drafting may lead to settlement negotiations coming under judicial scrutiny regardless of whether they were undertaken under the cloak of without prejudice.

JP MORGAN CHASE DEFEATS SPRINGWELL APPEAL

JP Morgan Chase has again successfully resisted claims of professional impropriety made against it by Springwell Navigation Corporation.

On 1 November 2010 a three judge panel sitting in the Court of Appeal dismissed Springwell's appeal brought against the earlier decisions of the High Court in 2008.

Springwell's claim against JP Morgan Chase arose out of the Russian financial crisis in the summer and autumn of 1998. Allegedly acting on the advice of one of JP Morgan Chase's emerging market salesmen, Springwell made significant investments in certain loan notes linked to Russian Federation issued bonds. As a result of the state of the Russian markets in 1998/9 those loan notes failed to perform, causing Springwell to suffer significant losses to the value of its portfolio, estimated to be in excess of US $700 million.

Springwell unsuccessfully sought to establish that JP Morgan Chase had steered it to invest in poor quality

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products and so was liable for the losses that Springwell had suffered as a result of those investments. After being unsuccessful in the High Court, Springwell was granted leave to appeal on just two of its allegations, namely that JP Morgan Chase was liable in that it had:

1) misrepresented to Springwell the risk profile of Springwell's investments; and

2) failed to take action after the Russian moratorium to recover some of the value of the forward currency contracts which were part of the linked notes.

The Court of Appeal dismissed both grounds of appeal. In dismissing the first ground of appeal, the Court took into account factors such as the nature of the alleged representations, the fact that there was no general duty of care on JP Morgan Chase to advise Springwell and the extent of Springwell's knowledge and understanding of linked notes and Russia. The second ground was dismissed by the Court on the basis that it found no wilful misconduct or gross negligence on the part of JP Morgan Chase in respect of the forward currency contracts.

The decision reiterates the robust approach that has traditionally been taken by the courts towards sophisticated investors (see, for example, the 1996 case of *Bankers Trust v Dharmala*). It is becoming increasingly clear that the courts do not consider that sophisticated clients trading in complex financial products over a lengthy course of dealing should readily be entitled to receive compensation from banks when investments turn sour.

Announcing our New Litigation Partner

We are pleased to announce that ***Steven Friel*** has joined the Firm's London office as a Partner in our Litigation Department.

Having previously practiced from the London and New York offices of Debevoise & Plimpton, Steven was for the last four years a partner in the London office of Davies Arnold Cooper. Steven has extensive experience in handling complex disputes, often with an international dimension. His recent work includes acting for Italian public authorities in derivatives disputes with a number of major international banks, and acting for third parties in the *Skype v Joltid* litigation in the English High Court, and in the subsequent settlement.

Steven is a graduate of Cambridge University and has a Masters degree in International Dispute Resolution from the University of London.

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BROWN RUDNICK is an international law firm with offices in the United States and Europe. Our 200 attorneys provide assistance across key areas of the law, including bankruptcy and restructuring, finance, complex litigation and arbitration, tax, corporate, government law and strategies, government contracts, intellectual property, climate and energy, and real estate.

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