



the global voice of  
the legal profession®

# International Litigation News

Publication of the International Bar Association Legal Practice Division

**OCTOBER 2018**



A conference presented by the IBA Litigation Committee



the global voice of  
the legal profession®

# IBA Annual Litigation Forum: Disruption in Litigation – new types of disputes in a new world order



Follow us  
[@IBAEvents](#)  
[#IBALit](#)

8–10 May 2019, The Ritz-Carlton, Berlin, Germany

## Topics include:

- Collective redress
- The effect of Protectionism and other geo-political forces on litigation
- Litigation game theory
- Blockchain/cryptocurrency litigation



FOR MORE INFORMATION AND TO REGISTER YOUR INTEREST VISIT  
[WWW.IBANET.ORG/CONFERENCES/CONF922.ASPX](http://WWW.IBANET.ORG/CONFERENCES/CONF922.ASPX)

## IN THIS ISSUE

<b>From the Co-Chairs</b>	<b>4</b>
<b>Editors' note</b>	<b>5</b>
<b>Committee Officers</b>	<b>5</b>
<b>IBA Annual Conference, Rome, 7-12 October 2018 – Our Committee's sessions</b>	<b>7</b>
<b>Features from our global members</b>	<b>10</b>
Tax havens, lies and videotapes: the fallout from the Panama Papers disclosures	10
#MeToo and mitigating litigation risk via culture change	13
What do millennial litigators want?	15
Litigation costs and third-party funding: avoiding the financial burden for clients	16
Shifting sands and buried treasure: how to uncover key documents and trace monies in complex cases	17
<b>NORTH AMERICA</b>	
The challenge of trying to fit cryptocurrencies under existing US financial regulatory statutes	19
'Libel tourism' and Canadian private international law conflicts rules in multi-jurisdictional internet defamation claims: <i>Haaretz.com v Goldhar</i> , 2018 SCC 28	22
The US crime-fraud exception to the attorney-client privilege	26
US Supreme Court: foreign government's construction of its national law gets 'respectful consideration' but not the last word	28
The impact of <i>inter partes</i> review on patent rights and patent litigation in the United States	30
<b>LATIN AMERICA</b>	
Collective actions: trends and currents in Latin America	33
<b>EUROPE</b>	
Taking it personally: individual accountability in the UK financial services sector	38
New ways to tackle fraud in the UK	40
Contractual freedom v contractual certainty: the UK approach to contractual No Oral Modification clauses	42
Expedited commercial trials in England: the way of the future or a flash in the pan?	45
The rise of 'hot-tubbing': the beginning of the end for expert cross-examination?	47
New implications of German civil procedure	49
Mass litigation in Germany: the current situation and perspective	51
Swiss courts dismiss foreign currency claims if the currency of the prayers for relief is wrongly denominated	53
Forum-running: Switzerland takes the lead	56
France: the creation of an international chamber specialised in cross-border disputes within the Paris Court of Appeal	59

Troubled waters in Spain on the concept of procedural public policy and the non-equivalence of court judgments and arbitral awards	62
Italian judges recognise the Russian roulette clause	64
Punitive damages in Italy	66
Concordat in light of recent amendments to the Turkish Code of Enforcement and Bankruptcy	68
Ukraine: commercial arbitration changes in 2018	71

### MIDDLE EAST

Saudi Arabia: companies law amendments may increase shareholder derivative litigation	72
Claims against foreign corporations in Israel	74

### ASIA PACIFIC

Cryptocurrency, litigation and the 'hard fork' remedy	76
---	----

### Newsletter Editors

Jane Colston Elliott Brown Rudnick, London jcolston@brownrudnick.com	Clément Dupoirier Herbert Smith Freehills, Paris clement.dupoirier@hsf.com
--	--

### International Bar Association

4th Floor, 10 St Bride Street  
London EC4A 4AD, United Kingdom  
Tel: +44 (0)20 7842 0090  
Fax: +44 (0)20 7842 0091  
www.ibanet.org

© International Bar Association 2018.

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, or stored in any retrieval system of any nature without the prior permission of the copyright holder. Application for permission should be made to the Director of Content at the IBA address.

### Terms and Conditions for submission of articles

- Articles for inclusion in the newsletter should be sent to the Newsletter Editors.
- The article must be the original work of the author, must not have been previously published, and must not currently be under consideration by another journal. If it contains material which is someone else's copyright, the unrestricted permission of the copyright owner must be obtained and evidence of this submitted with the article and the material should be clearly identified and acknowledged within the text. The article shall not, to the best of the author's knowledge, contain anything which is libellous, illegal, or infringes anyone's copyright or other rights.
- Copyright shall be assigned to the IBA and the IBA will have the exclusive right to first publication, both to reproduce and/or distribute an article (including the abstract) ourselves throughout the world in printed, electronic or any other medium, and to authorise others (including Reproduction Rights Organisations such as the Copyright Licensing Agency and the Copyright Clearance Center) to do the same. Following first publication, such publishing rights shall be non-exclusive, except that publication in another journal will require permission from and acknowledgment of the IBA. Such permission may be obtained from the Director of Content at [editor@int-bar.org](mailto:editor@int-bar.org).
- The rights of the author will be respected, the name of the author will always be clearly associated with the article and, except for necessary editorial changes, no substantial alteration to the article will be made without consulting the author.

This newsletter is intended to provide general information regarding recent developments in international litigation. The views expressed are not necessarily those of the International Bar Association.

### Advertising

Should you wish to advertise in the next issue of the newsletter, please contact [andrew.webster-dunn@int-bar.org](mailto:andrew.webster-dunn@int-bar.org)

## From the Co-Chairs

### Ira Nishisato

Borden Ladner Gervais,  
Toronto  
inishisato@blg.com

### Tom Price

Gowling WLG,  
Birmingham, UK  
tom.price@  
gowlingwlg.com

It was a pleasure to see so many members at the 2018 Annual Litigation Forum, held in Chicago in May. The excellent sessions, memorable social events and record attendance for North America made this year's Forum one of the Litigation Committee's most successful.

The comments received from delegates were enormously positive – including from many who were attending for the first time. It is clear that we have the right recipe of working sessions and activities that are both beneficial from a networking perspective and very enjoyable. We once again extend our profound appreciation to Larry Schaner and the Organising Committee for all their hard work.

We now look forward to the IBA 2018 Annual Conference in Rome with great excitement and anticipation. The Committee is leading and supporting an increased number of sessions this year. The session chairs have been hard at work planning diverse and interesting topics, and attendance by delegates is critically important in ensuring the Committee receives session slots in future years – so we strongly encourage you to attend.

We are delighted to continue hosting the IBA Global Women Litigators' Breakfast on the Tuesday morning (both women and men are welcome), and our traditional Committee lunch cruise on the Thursday afternoon.

After Rome, we head to Accra, Ghana, where the Committee's African Regional Conference on 15–16 November will explore 'Litigation and dispute resolution in emerging and frontier markets – the case of Africa'. This will be our first conference in Africa, and a great way to introduce the Committee to African lawyers. We ask all members to please consider attending to help showcase the breadth, depth and diversity of our Committee.

Planning is well underway for our 2019 Annual Litigation Forum in Berlin on 8–10 May. The theme will be 'Disruption in litigation: New types of disputes in a new world order'. The German capital is a fascinating and fun city that will serve as an excellent host for the Committee.

It remains critically important for the Committee to continue welcoming new members to our conferences, including younger litigators. We invite each of you to bring colleagues from your firms to join and become active.

Finally, we would like to commend the Editors of this latest newsletter, Jane Colston and Clément Dupoirier, for the high-quality and breadth of articles they have assembled. The Committee is justly proud of its newsletter, and this edition certainly meets the high standards that have been set in the past.

We are grateful to all of you for your continuing support of the Committee. We look forward to seeing you in Rome very soon.

**Jane Colston Elliott**

Brown Rudnick,  
London  
jcolston@  
brownrudnick.com

**Clement Dupoirier**

Herbert Smith Freehills,  
Paris  
clement.dupoirier@  
hsf.com

## Editors' note

**T**his latest Litigation Committee newsletter underlines how the 'global village' results in ever-more complex cross-border issues for us litigators.

The increasing criminalisation of the corporate world means litigators need to be mindful of the interplay of regulatory, civil and criminal laws across borders. We're also seeing a surge in litigation, and risks to reputation, from the #MeToo movement, emphasising how change in culture is key. Articles in this edition explore some of the issues that are emerging.

Law firms face many other challenges, including retention of top talent. We hear from one young litigator on the expectations of millennial lawyers. Firms also face

growing calls from clients to use artificial intelligence in order to win litigation cost efficiently – and we see how one firm did this. Furthermore, and unsurprisingly, collective redress is still a very hot topic, as is the control exercised by national courts over arbitral awards. Articles in this edition consider these areas too.

We extend our warmest thanks to all of our fellow litigators who have contributed to another must-read edition of the newsletter. To our readers, we hope you enjoy it as much as we did curating it.

The next edition, due out in the run-up to the Annual Litigation Forum in 2019, is now in our sights. Please do keep contributing and sharing your know-how and experiences.

## Committee Officers

**Co-Chairs**

Ira Nishisato  
Borden Ladner Gervais, Toronto  
inishisato@blg.com

Tom Price  
Gowling WLG, Birmingham  
tom.price@gowlingwg.com

**Senior Vice-Chairs**

Angelo Anglani  
Nctm Studio, Milan  
angelo.anglani@nctm.it

Tim Strong  
Taylor Wessing, London  
t.strong@taylorwessing.com

**Vice Chairs**

Frederick Acomb  
Miller Canfield, Detroit  
acomb@millercanfield.com

Yvette Borrius  
Florent, Amsterdam  
yvette.borrius@florent.nl

**Secretary**

Carlo Portatadino  
Tosetto Weigmann & Associati, Milan  
carlo.portatadino@studiotosetto.it

**Treasurer**

Christie Helmer  
Miller Nash Graham & Dunn, Portland  
chris.helmer@millernash.com

**PPID Liaison Officer**

Peter Chaffetz  
Chaffetz Lindsey, New York  
peter.chaffetz@chaffetzlindsey.com

**Scholarship Officer**

Simon Hart  
RPC, London  
simon.hart@rpc.co.uk

**Regional Representative Asia Pacific**

Neerav Merchant  
Majmudar & Partners, Mumbai  
nmerchant@majmudarindia.com

**Regional Representative Latin America**

Rodrigo Fermin Garcia  
Marval O'Farrell & Mairal, Buenos Aires  
rfg@marval.com

**Regional Representative Africa and Middle East**

Jacques Bouyssou  
Alerion, Paris  
jbouyssou@alerionavocats.com

## COMMITTEE OFFICERS

### Publications Officers

Sara Louise Chisholm-Batten  
Michelmores, Exeter  
sara.chisholm-batten@michelmores.com

Thera van Swaay de Marchi  
Pinheiro Neto, São Paulo  
tdemarchi@pn.com.br

### Newsletter Editors

Jane Colston Elliott  
Brown Rudnick, London  
jcolston@brownrudnick.com

Clement Dupoirier  
Herbert Smith Freehills, Paris  
clement.dupoirier@hsf.com

### Conference Quality Officer

Urs Feller  
Prager Dreifuss, Zurich  
urs.feller@prager-dreifuss.com

### Conference Coordinator Europe

Peter Bert  
Taylor Wessing, Frankfurt  
p.bert@taylorwessing.com

### Committee Liaison Officer

John Reynolds  
White & Case, London  
johnreynolds@whitecase.com

### Website Officers

Jeff Galway  
Blake Cassels & Graydon, Toronto  
jeff.galway@blakes.com

Marko Hentunen  
Castrén & Snellman, Helsinki  
marko.hentunen@castren.fi

### Website Editor

Felix J Montero Muriel  
Perez-Llorca, Madrid  
fmontero@perezllorca.com

### Diversity and Equality Officer

Daan F Lunsingh Scheurleer  
NautaDutilh, Amsterdam  
daan.lunsingh@nautadutilh.com

### Membership and Communications Officer

John P Bang  
Bae Kim & Lee, Seoul  
john.bang@bkl.co.kr

### Sponsorship Officer

Sae Youn Kim  
Yulchon, Seoul  
kimsy@yulchon.com

---

### Young Litigators Forum

#### Co-Chairs

Anna Grishchenkova  
KIAP, Moscow  
ag@kiaplav.ru

Sandrine Giroud  
LALIVE, Geneva  
sgiroud@lalive.ch

---

### LPD Administrator

Susan Burkert  
susan.burkert@int-bar.org



# IBA 2018



## ROME 7–12 OCTOBER

ANNUAL CONFERENCE OF THE INTERNATIONAL BAR ASSOCIATION

### Litigation Committee's sessions

**Monday 1430 – 1730**

**Mock trial: the briber's dilemma facing parallel criminal, arbitral and civil asset recovery proceedings**

*Presented by the Criminal Law Section, the Anti-Corruption Committee, the Arbitration Committee, the Business Crime Committee, the Corporate Counsel Forum, the Criminal Law Committee and the Litigation Committee*

Bribery and corruption occur throughout business and increasingly lead to parallel criminal, arbitral and civil proceedings. The proof of corruption in those three types of proceedings is subject to different rules and practices. In particular, privilege, right against self-incrimination, admissibility of evidence and publicity apply differently. The Criminal Law Section's interactive and ever-popular mock trial will explore how evidentiary issues are managed in criminal, arbitral and civil asset recovery proceedings by having the same persons examined by an Italian criminal court, an International Centre for Settlement of Investments Disputes (ICSID) arbitral tribunal and the English High Court on the same set of facts.

AULA DELLA TORRE, CORTE SUPREMA DI CASSAZIONE

**Monday 1615 – 1730**

**Privileged and confidential: cross-border differences in the protection of confidential information**

*Presented by the Dispute Resolution Section, the Arbitration Committee, the Consumer Litigation Committee, the Litigation Committee, the Mediation Committee and the Negligence and Damages Committee*

Privileged and confidential – do these 'magic words' provide sufficient protection? Lawyers use them all the time, but they are not always used consistently or correctly. The protections available vary greatly among legal systems. In some jurisdictions, the failure to correctly mark a document or designate a conversation is fatal to the claim of privilege or confidentiality. In others, dawn raids by criminal or regulatory authorities can result in privileged documents, such as internal investigation reports, finding their way into an adversary's hands. Legal counsel may refuse to produce evidence or provide testimony, but if the client has waived privilege or confidentiality,

even implicitly or inadvertently, the protection may be rendered meaningless. In arbitration, privilege is not always uniformly applied. This panel will explore the legal and practical differences worldwide to assist international lawyers in dealing with privileged and confidential information, and in better understanding the legal and practical boundaries of protection available to them.

**Tuesday 0800 – 0915**

**Global Women Litigator Breakfast: building winning, inclusive teams – generating 'social capital' within your organisation**

*Presented by the Litigation Committee and the Women Lawyers' Interest Group*

**Tuesday 1115 – 1230**

**Judges or arbitrators: comparisons between courts and arbitral tribunals, the view of advocates – do retired judges or seasoned advocates make good arbitrators and does arbitration need litigation on top?**

*Presented by the Forum for Barristers and Advocates, the Arbitration Committee and the Litigation Committee*

This session will explore procedural distinctions between arbitral tribunals and traditional courts, and the extent to which there are variations between:

- common and civil law systems;
- arbitral institutions that provide for greater court scrutiny; and
- arbitration in general commercial cases as opposed to specialists London Maritime Arbitration Association (LMAA).

The session will discuss the relative merits of procedures governing dispute resolution before courts or private bodies. It will examine the extent to which arbitration (both substance and procedural rules) require an element of judicial scrutiny in light of the fact that most are private/confidential. The identity and experience of arbitrator-types will be discussed. The session may also examine whether the development of a single transnational arbitral institution is a good idea in principle.

*Continued overleaf*

## Tuesday 1430 – 1545

### **Litigation proceedings involving repossession of aircraft: enforcement of rights under the Cape Town Convention and conflict of laws between common and civil law systems**

*Presented by the Aviation Law Committee and the Litigation Committee*

This international panel will discuss important issues regarding the rights of variously situated parties in aircraft/aircraft engines and the alternatives for enforcing those rights. Among the topics to be explored are relevant provisions of the Cape Town Convention on International Interests in Mobile Equipment, including legal remedies for default in transactions under the Convention, and a comparative law analysis of the applicable enforcement procedures and substantive law in different countries.

## Tuesday 1430 – 1545

### **Post-closing claims: when the deal goes wrong**

*Presented by the Litigation Committee and the Corporate and M&A Law Committee*

This panel of cross-border litigators and deal lawyers will discuss which representations and warranties in M&A agreements most commonly result in claims for breach. They will examine the most common themes in purchase price adjustment disputes and earn-out disputes, evaluate the most common issues in claims for breach of the covenant not to complete, the covenant not to solicit employees or customers, and the covenant not to disclose confidential information, identify the most typical fact patterns in post-closing fraud claims, and identify winning strategies for pursuing, defending and settling the foregoing claims and disputes.

## Tuesday 1615 – 1730

### **Data privacy and cybersecurity litigation**

*Presented by the Litigation Committee and the Cybercrime Subcommittee*

Data privacy breaches, resulting criminal investigations and cybersecurity civil litigation, are on the rise and will be well into the foreseeable future. All breaches of data privacy – whether the product of human error or, more likely, the result of planned, sophisticated attacks, including hacking, phishing, malware and ransomware – are exponentially increasing the risk of litigation, governmental investigations and other legal consequences for which companies, even – or, perhaps, especially – the most cutting-edge companies, now require, seasoned and competent counsel to guide and litigate this invasion of computer-based privacy matters. As hackers and cybercriminals continue to find more creative ways to access data, breaches have included confidential business information, trade secrets and other sensitive and valuable data; personal information, including health-related information, social

security numbers, passwords, financial information of consumers and customers, including credit card and bank account information; and a plethora of storable, unauthorised data that can be used directly against the company, and to indirectly generate claims and inquiries against it. Counsel has to be prepared to litigate the adequacy and effectiveness of, and to assess and develop, cybersecurity measures in this burgeoning area. The panel will assist counsel to stay current in both liability issues, and the legal framework surrounding data breaches. It will explore technical and procedural safeguards being tested, through an increase in protective laws, regulations and rapidly evolving legal standards designed through differing jurisdictional regimes, all designed to make companies improve protections against threats, minimise risks to third parties and prepare their clients to both prosecute and weather the protracted litigation cyberstorm that has broken in full force. The panel will discuss data breaches that lead to investigations by governmental agencies, regulatory fines and sanctions, shareholder suits, private litigation and class actions by consumers, patients, customers, suppliers and employees.

## Wednesday 0930 – 1045

### **Specialised intellectual property courts**

*Presented by the Intellectual Property and Entertainment Law Committee and the Litigation Committee*

Are specialist courts the way forward for intellectual property? A panel of judges and practitioners from around the world will discuss the development of specialist courts, their advantages and possible disadvantages in an interactive session. Come along and give us your views.

## Wednesday 1115 – 1230

### **Changes in national laws that may undermine mining development agreements: remedies for investors**

*Presented by the Mining Law Committee, the African Regional Forum and the Litigation Committee*

This session will discuss the imposition of new legislation that contradicts existing mining development agreements and the issues that could arise between conflicting laws, national and international.

## Wednesday 1430 – 1545

### **The art of witness examination**

*Presented by the Litigation Committee*

The role of the witness (both factual and expert) is often key in any dispute. But quite what that role is varies from jurisdiction to jurisdiction such that litigating away from your home court can hold traps for the unwary. This session will focus on what those traps might be. Previous sessions have looked at how different ethical rules deal with witness preparation. This session will focus on the evidence itself and the giving of it, what form the evidence takes

(written statement or oral evidence), how that evidence is collected, how witnesses are questioned in court and how the judge intervenes. What styles of witness questioning work and what does not work? Are there any formal rules to consider, for example, taking evidence by video link may be unlawful in some countries. Does the process vary with expert witnesses? The session will help all those involved in cross-border litigation to have a better understanding of this crucial part of the dispute resolution process.

## Thursday 1115 – 1230

### Collective redress in Europe: coordination or conflict with international class actions

*Presented by the Litigation Committee and the Consumer Litigation Committee*

Now that the European Union has announced its 'new deal for consumers' that introduces a European collective redress right that allows for both injunctive and compensatory relief, separate collective redress actions and class actions can be pursued simultaneously in Europe and elsewhere in the world seeking the same or similar relief against common defendants for alleged wrongdoing. It is important to consider how these experiences are, and in the future will be, affecting such issues as whether opt-in or opt-out models will prevail, what is the proper forum and applicable law to resolve such disputes, and how and where cross-border recognition and enforcement can be successfully implemented.

The Litigation Committee and the Consumer Litigation Committee are joining forces in Rome to address these issues. A panel of experts from across the globe, on both sides, claimant and defendant, will lead an interactive discussion on how the legal markets are reacting to these developments and what further measures should be considered to address the fears of those potentially exposed to class actions and/or collective redress claims, all while providing guidance

to proper access to justice. Litigators, corporate counsel, judges, academics, consumer association representatives and policy-makers can profit from attending this session, which will focus not only on discussing the current state of play but also future developments.

## Thursday 1115 – 1230

### Impact of international economic sanctions to the mining sector and how to manage risks

*Presented by the Mining Law Committee, the Banking Law Committee, the Criminal Law Committee, the International Trade and Customs Law Committee and the Litigation Committee*

Economic sanction regimes, particularly those promulgated from the United Nations, European Union and United States, can have a significant impact on the exploration and production activities of mining firms and related service providers. Depending on the particular sanctions programme, prohibitions may range to a comprehensive embargo on all trade with a country or government, including state-owned enterprises, to more targeted restrictions that penalise dealings with certain persons (ie, individuals, entities or vessels), which could be customers, suppliers, service providers, subcontractors, employees, operators or other business partners. Sanctions can affect offshore conduct, and penalties or other liabilities that may be imposed can contribute to negative financial conditions and reputational damage. This session will review existing sanction programmes of the principal sanctioning authorities (UN, EU and US) and explore how the risks created by those programmes can be most effectively managed.

All programme information is correct at time of print.

To find out more about the conference venue, sessions and social programme, and to register, visit [www.ibanet.org/Conferences/Rome2018.aspx](http://www.ibanet.org/Conferences/Rome2018.aspx).

Further information on accommodation and excursions during the conference week can also be found at the above address.



Susan Monty

Solicitor, London

s.monty@frc.org.uk

# Tax havens, lies and videotapes: the fallout from the Panama Papers disclosures

The well-publicised disclosures of client documents from two major law firms, in the Panama Papers and Paradise Papers scandals, made fascinating front page news in 2016 and 2017. Politicians and their associates in over 40 countries, royalty, multinationals, and celebrities were ‘outed’ for protecting their assets through corporate or trust entities in offshore tax havens. Depending on one’s viewpoint, the disclosures amounted to a welcome scrutiny of tax havens or an unwarranted attack on privacy, but ten months on, the issues raised continue to dominate approaches to tackling cross-border corruption.

## A recap of the scandals

On 9 May 2016 a consortium of investigative journalists released 11.5 million documents which had been ‘leaked’ from Mossack Fonseca, a Panamanian law firm, and at the time of the scandal, the largest provider of offshore legal services in the world. Eighteen months later, a further 13.4m documents were leaked from Appleby law firm, Asiatic Trust and business registries in some 19 other tax jurisdictions. The two disclosures contained detailed financial and legal information on over 300,000 offshore entities. The material had been stolen in 2015 by a whistleblower with relative ease.<sup>1</sup>

As lawyers will appreciate, there is nothing illegal per se about establishing a company or trust located outside one’s home country, but the purpose for which the assets are transferred often makes it so.

## Who takes the blame?

Mossack Fonseca put out a statement blaming other professionals: ‘We’ve done [no]thing illegal... responsibility for any legal violations might lie with other institutions: approximately 90% of our clientele is comprised of professional clients... who act as intermediaries and are regulated in the jurisdiction of their business. These clients are obliged to perform due diligence on their clients in accordance with the KYC and AML regulations to which they are subject’.

Panama’s Lawyers Movement labelled the disclosures ‘cyber bullying’ and Panama’s President called it a ‘direct attack on the country’s financial system’. Mossack Fonseca closed, blaming reputational damage.

Appleby asserted that this was, ‘not a leak... but... a serious criminal act... an illegal computer hack’ and in December 2017 brought an action against the *Guardian* and the BBC for breach of confidence. That action was settled in May 2018.

The scandals and public figures associated with them led to high-profile resignations, including the prime ministers of Iceland and Pakistan.

Criminal investigations and prosecutions have commenced and tax authorities around the world have so far recovered more than \$500m, with undoubtedly more to follow.

The leaks created debate about privacy versus secrecy and propelled the issue of anti-money laundering (AML) to the top of international summit agendas, since the real issue was, as stated by Transparency International, that: ‘the system is broken... complex, cross-border structures are being used to facilitate a wide range of secret activity, which could include corruption, fraud and abusive tax schemes.’<sup>2</sup>

## Consequences in the EU

European lawyers were already unavoidably aware of their responsibilities as ‘gatekeepers’ in the fight against money laundering and tax evasion. The European Union implements, through anti-money laundering Directives (AMLD’s), the recommendations of the Financial Action Task Force (FATF), an inter-governmental organisation of 108 jurisdictions, designed to develop and promote national and international policies to combat the global threat of money laundering and terrorist financing. Each country legislates within its own national jurisprudence.

In general terms, European lawyers have accepted, through implementation of the second and third AML Directives, positive duties to verify clients through due diligence, and to report suspicions of any transaction which a lawyer knows, or suspects to be criminal money laundering. These override both client

confidentiality and legal privilege, (save where the advice is given to a client with a view to litigation). Non-compliance by the lawyer risks criminal prosecution and disciplinary action.

In the light of the Panama and Paradise scandals, on 19 April 2018 the EU voted in urgent counter measures and adopted the Fifth Money Laundering Directive (AMLD5)<sup>3</sup>, which must be implemented by 2020 and includes:

- increasing transparency about companies and trusts ownership through establishing publicly accessible beneficial ownership registers in EU countries;
- measures to improve safeguards for financial transactions with high-risk third countries;
- extending the scope of industries subject to MLD5 (art dealers, tax advisors, letting agents and crypto currency exchanges will be required to verify the identity of clients and to perform customer due diligence); and
- enhancing the access of Financial Intelligence Units to information, including centralised bank account registers.

## The United Kingdom's response

### *Brexit and the EU directive*

The UK has previously taken a major role in the EU's fight against money laundering and corruption, both in drafting the legal framework of the AML directives and also in their implementation, often going beyond the strict requirements of the directives. The impending departure of the UK from the EU on 29 March 2019 ('Brexit Day') means that AMLD5 may not actually be in force by the time the UK leaves. It is unclear what the consequences might be, or how action would be taken by the European Commission and European Court of Justice in a situation where their authority is no longer recognised by the UK as supreme. Through the UK's own core aims,<sup>4</sup> and its membership of FATF, it is likely that the provisions of AMLD5 will in fact be enacted in UK legislation.

### *Extension of corporate registry of beneficial interests to British Overseas Territories*

The UK is the only country in the world that already maintains a publicly-available register of company beneficial ownership, introduced in 2016. This provision anticipates AMLD5. Companies are required to declare 'persons of significant control' to Companies House when issuing their annual confirmation statement.

The Panama and Paradise disclosures featured very large numbers of companies

registered in British Overseas Territories or Crown Dependencies, and this persuaded the UK Parliament to pass the Sanctions and AML Act in May 2018, which extends the requirement to introduce a publicly-accessible, company-beneficial ownership register to British Overseas Territories (BOT) by the end of 2020.

The BOTs responded with indignation at what they perceived to be scapegoating for the Panama and Paradise scandals, since in 2016 they already committed to introduce central registers of beneficial ownership or 'similarly effective systems' by 30 June 2017, which would be available to law enforcement agencies on request. Furthermore, whilst anyone can open a company in the UK, you need to go through a licensed operator in the BOT's, who performs due diligence checks on the data. Finally, the measures will not apply to the Crown Dependencies of Jersey, Guernsey and the Isle of Man, which the BOT's see as discriminatory.

Cayman has threatened legal action and Gibraltar has stated it will not enforce the new law, describing it as 'an unacceptable act of modern colonialism'.

### *Use of unexplained wealth orders*

Transparency International identified over 86,000 UK properties owned through companies based in offshore locations, and some \$4bn worth of UK property bought with 'suspicious wealth'. There is, as yet, no public registry of UK owned property, but a new measure, which was used for the first time in February 2018, enables UK authorities to seize property bought in the UK with laundered funds, which are reasonably suspected of being the proceeds of serious crime or of corrupt foreign politicians and their associates. The burden is on the respondent to explain their assets if they appear disproportionate to their income. If no satisfactory explanation is given then the property is recoverable under civil recovery provisions.

### *Pressure for introduction of economic crime offence and review of Bribery Act*

There is pressure to expand corporate criminal liability<sup>5</sup> through the introduction of a corporate offence of failing to prevent money laundering, similar to the existing offences of the failure to prevent bribery and the failure to prevent facilitation of tax evasion. Meanwhile the burden such offences create on SMEs is one of the matters currently being considered by a House of Lords committee on the impact of the UK's

Bribery Act, widely recognised as being the toughest in the world.

### *Review of UK's anti-money laundering supervisory system*

In January 2018, the Office for Professional Body Anti-Money Laundering Supervision (OPBAS) was created to supervise the 25 UK organisations which supervise AML compliance in the UK, pursuant to EU Directive AML4. There have been complaints that whilst UK lawyers are gatekeepers, in fact the legal sector made up less than one per cent of reported suspicious transactions between October 2015 and March 2017.

### *The United States*

In the US, AML compliance is carried out primarily by banks and other financial institutions, pursuant to the US Bank Secrecy Act (BSA) and enforced through the US Treasury Department's AML unit, the Financial Crimes Enforcement Network (FinCen). Following the Paradise Papers leaks, in which US corporations featured predominantly, there has been internal scrutiny by the Senate Banking Committee<sup>6</sup> and external criticism (FATF<sup>7</sup>, Transparency International<sup>8</sup>) which highlighted AML weaknesses and is stimulating reform.

The US aligns with countries such as China, Indonesia and Saudi Arabia in its lack of beneficial ownership transparency frameworks for corporations or property ownership. A bill in Congress, the Counter Terrorism and Illicit Finance Act (CTIFA), if implemented, will improve the position. Corporations, with some exceptions, will be required to identify their beneficial owners, obtain certain basic information about them and register in the United States' first national directory of beneficial corporate ownership, although accessible to law enforcement agencies only.

Currently, there are no US laws requiring lawyers to execute AML checks on clients or money they handle. A proposed Corporate Transparency Act of 2017 would include certain lawyers within the definition of corporate 'formation agents', subjecting them to suspicious activity and money laundering reporting obligations under the BSA. The American Bar Association (ABA) opposes attorney AML reporting as an attack on a bedrock of the US legal system: attorney-client privilege and client confidentiality.

Disclosures of the nature which are required in Europe and the UK are perceived as whistleblowing on their clients, and an irreconcilable conflict of interest.

The ABA has issued voluntary guidance on recognising suspicious transactions and their advice is to decline to act. However, in an undercover investigation in 2016, posing as an advisor to a foreign government minister, Global Witness asked 13 New York law firms how to anonymously move large sums of money. In all but one case, the lawyers provided suggestions as to how the minister might get the money into the US without deception.<sup>9</sup>

Further, while the US government has successfully prosecuted foreign officials under the Foreign Corrupt Practices Act (FCPA), which makes bribery of foreign government officials by US corporations a crime, President Donald Trump has called the FCPA 'a horrible law' and demanded that it be rolled back.

### **Conclusion**

The consequences of the scandals will continue to unfold over coming months and years. One of the more fascinating aspects for lawyers has been the light shone on lawyer-client relationships, which we balance with our responsibilities to the regulators. It also demonstrates that lawyers in one jurisdiction may not assume that their foreign colleagues in another have carried out third-party AML checks on which they may rely.

### **Notes**

- 1 Chris Kubecka, *Down the Rabbit Hole: An OSINT Journey*.
- 2 Delia Ferreira Rubio, chair of Transparency International.
- 3 (2016/0208(COD)) (MLD5).
- 4 The core aims of the UK Anti-Corruption Plan 2017-22 include strengthening the integrity of the UK as an international financial centre through greater transparency over who owns and controls companies and other legal entities, stronger law enforcement, prosecutorial and criminal justice action and enhanced anti-money laundering.
- 5 See, for example, [www.sfo.gov.uk/2018/06/21/corporate-criminal-liability-ai-and-dpas/](http://www.sfo.gov.uk/2018/06/21/corporate-criminal-liability-ai-and-dpas/)
- 6 [www.nytimes.com/2016/04/07/world/americas/us-plans-to-require-banks-to-identify-owners-of-shell-companies.html](http://www.nytimes.com/2016/04/07/world/americas/us-plans-to-require-banks-to-identify-owners-of-shell-companies.html)
- 7 [www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf)
- 8 [www.transparency.org/whatwedo/publication/transparency-in-corporate-reporting-assessing-emerging-market-multinat](http://www.transparency.org/whatwedo/publication/transparency-in-corporate-reporting-assessing-emerging-market-multinat)
- 9 [www.globalwitness.org/en/reports/loweringthebar/](http://www.globalwitness.org/en/reports/loweringthebar/)

**Ari Joseph**

Brown Rudnick,  
New York and London  
ajoseph@brownrudnick.  
com

# #MeToo and mitigating litigation risk via culture change

**T**he *Times* reported on 28 July 2018 that ‘a leading university has abandoned non-disclosure settlements in sexual harassment cases after the number of complaints made against staff more than doubled in a year... paying out tens of thousands of pounds. Two other institutions have made similar payouts.’ These figures are emerging because, for example, Freedom of Information Requests are being made by the media and by others. In every industry cultural norms are changing and if recent developments involving Donald Trump and London universities are any indication, non-disclosure agreements found in sexual harassment settlements are quickly becoming a relic of the past, seen as inappropriate and inconsistent with a culture of greater transparency and openness. As the litigation risk of unfair treatment, unequal pay and harassment increases, creating and maintaining an equitable and inclusive workplace culture has never been more important. In the #MeToo era, companies that discriminate risk reputational and financial harm.

The benefits of having an equitable and inclusive workplace are many. In addition to decreased litigation risk, retention rates for all people, regardless of demographic background, improve. Women, people of colour and millennials in particular have strongly indicated that a diverse workforce is among the most important factors they consider when choosing an employer.

Additionally, a diversity of experience and thought among its employees provides an organisation with a competitive business advantage, and there is a growing body of evidence that companies, for example, employing multiple women at the C-Suite level, outperform those with only men at the helm.

## What can be done?

Hiring and promoting women into leadership roles is the obvious and most effective action that a company can take, yet female representation at the highest levels

of organisations and in management has remained stagnant for a decade. This is not due to a lack of financial commitment to ‘diversity’. Fortune 500 companies spend over \$16bn annually on consultants, heritage month events, diversity awareness campaigns, and sexual harassment training. Throwing money at a problem, however, rarely makes it go away. Before gender parity can be achieved, women must first feel as if their values, goals, and differences are respected and embraced by an organisation’s leaders.

Gender parity is attainable if companies invest in fostering diversity throughout their ranks as if it were a strategic business objective with quantifiable goals that business leads are held accountable for. What follows are concrete steps that an organisation can take to increase female representation throughout its ranks.

## Dismantle the old networks

All cultures are created and they tend to be easier to navigate for members of the demographic groups who designed them. This holds true across organisations and industries. Many of the social aspects of work, such as outings centred on alcohol consumption, sporting events, or golfing, do not appeal to everyone. As a consequence, employees who are not interested in such activities are often provided with fewer mentoring, sponsorship and professional and client development opportunities.

If companies truly want to increase retention rates for women and advance them to positions of leadership, they must do the hard work of identifying where implicit biases impact the business and people decisions within their organisations. Strategic thought must be given to what client events look like, how matters are staffed and who gets face-time with key-lever partners and important clients. Have drinks after work, but take teams out for lunch as well. In addition to sporting events, attend the theatre or opera. Instead of hosting golf outings, host client events at museums or art galleries. Expanding the types

of activities a company sponsors and supports also expands the range of what is considered normal within a culture.

### **Assign accountability**

Incentives strongly influence human behaviour. Only by assigning accountability to team leaders and other members of senior management will companies be able to ensure that efforts to achieve gender parity are implemented.

### **Commit spend strategically**

Spend should be allocated to areas of strategic operational importance. Specific areas worth investing in include: culture/equity and inclusion departments; professional/talent development departments; employee resource groups (ERGs); cultural education and implicit bias mitigation initiatives. Experts can provide guidance as to which initiatives to focus on for maximum effect in your organisation and a director or chief of culture/equity and inclusion should be hired and empowered as a member of senior management.

### **Obtain data and evaluate culture**

Data is an essential component of all efforts to achieve gender parity. Before committing to any strategic initiatives, companies should first establish a baseline of their demographics at all levels, their hire and attrition rates based on demographics and employee perceptions of organisational equity and inclusion. This data will allow companies to track the efficacy of their efforts and allow for accountability to be assigned. Data also helps businesses identify which departments have problems recruiting and retaining women, which supervising lawyers may have issues with discrimination or harassment and which teams and individuals should be publicly acknowledged and rewarded for their equity and inclusion efforts.

### **Update policies and procedures**

Few aspects of an organisation impact its culture more than its policies and procedures. Policies are benefits, written rules or guidelines that establish what is acceptable and what is unacceptable behaviour. Parental leave, adoption, and flexible work

arrangements are common examples of policies that every organisation should have. Ensuring that such policies are drafted in an unbiased manner and enacted and applied fairly is an important first step toward creating the kind of workplace environment that is attractive to women.

Procedures are unwritten rules or norms that, while malleable, significantly impact organisational culture. Are women receiving opportunities to work on important matters with big clients? Are there supports established for working mothers when they return from maternity leave? Are the company's anti-harassment and discrimination policies enforced against all bad actors, regardless of position or title? If your company has progressive policies in place yet still lacks gender parity, there is a good chance that your procedures are not as equitable and inclusive as they could be.

### **Provide implicit bias education and mitigation strategies.**

By now, we all have heard of implicit, or unconscious, biases and their negative effects on an organisation's equity and inclusion. While combating bias is important, studies have shown that implicit bias trainings often have no effect, and at times may even cause a backlash when they are made mandatory. This is because most implicit bias trainings do not provide strategies for mitigating them, leaving participants with a feeling of helplessness.

Researchers have identified over 150 forms of implicit biases and no one method of addressing bias works for them all. By focusing on biases that are most likely to affect business and people operations at a company, such as in-group bias, distance bias, and confirmation bias and by providing discrete methods of preventing or countering their impact, bias education can be an effective business tool rather than just another 'diversity' training.

### **Conclusion**

Gender parity is achievable, so long as organisations treat their culture change efforts as they would any other business goal. Companies can maximise the financial advantages that gender parity provides and minimise their liability for discrimination and harassment claims by using data, being strategic in their efforts and assigning accountability.

**Francesca Dalla Volta**

Brown Rudnick,  
London

fdallavolta@  
brownrudnick.com

# What do millennial litigators want?

## Not to be called lazy

Today, the number of training contracts offered by firms has decreased and entering the profession has become highly competitive. Knowing the law is not enough: millennial litigators must demonstrate several other skills including intellectual intelligence (IQ), emotional intelligence (EQ), tech-awareness, commercial awareness, client management skills and marketing skills. Preferably, millennial lawyers will speak multiple languages as this helps them in their relationships with international clients. Many understand these benefits and are actively starting their own business development (BD) activities in order to build up their own client network early on in their career.

## Using artificial intelligence to solve problems

The advent of artificial intelligence (AI) in recent years has impacted many industries and law is no exception. From carrying out legal research to analysing large data sets quickly and well, AI technology is a useful tool for carrying out tasks once reserved for paralegals and junior lawyers. In the past, firms would have put a team of junior lawyers in a room to review hundreds of documents and extract the relevant information (an expensive process which could take weeks). Today, AI technology can extract the same information in a fraction of the time.

Firms' resistance to invest in the technology, (eg, because it will reduce billable hours and impact on targets) is being worn down by client demand for efficiency. Junior lawyers who are tech-aware and clearly understand technology's application to the delivery of legal services are becoming the 'new wanted', as they help firms to exploit new technologies which can improve the range of services offered to clients. Millennials believe that if AI is used it can allow firms to carry out previously unmanageable projects, thereby increasing revenue and accelerating their own

meaningful participation within the team.

Increasingly, millennials believe that the traditional litigation team will include experts in the use of AI platforms; tech-awareness is becoming as important a skill to master as the traditional skills required of litigators.

## Better work-life balance

Many senior lawyers might argue that law is not and has never been the career for people who hope to go shopping during lunchtime and want to be back home in time to catch the end of a TV show. Millennial lawyers would agree, but as society becomes more understanding of mental health problems and the impact of stress on these, the mentality of 'working until you drop' is changing.

Statistics published by the Health and Safety Executive on work-related stress, depression or anxiety place 'legal professionals' third in a list of the top four most stressful jobs in the UK. According to the statistics, 3,010 of every 100,000 workers in the legal industry have reported feeling stress, depression or anxiety in the past three years (from 2014 to 2017). According to the report the main reported cause was workload, in particular the need to meet tight deadlines, too much work or too much pressure or responsibility.

While millennial lawyers are happy to work long hours when necessary, they want to use technology to work in a way that is smarter, rather than for longer. They are aware of the efficiency and flexibility that technology offers and want to use this to their own advantage.

According to a report from Deloitte, 'they [millennial lawyers] are more interested in people than in money'. Millennials may receive lower incomes, but earning will not require them to be regularly tied to a desk for extremely long hours. In this way, they are exposing the inefficiencies of the system and they contribute to create a better work model.

## A diverse workplace

The Deloitte report further states that millennial lawyers ‘prefer collaborative working structures’. For instance, they don’t like firms with a hierarchical structure; rather, they want to be part of a collaborative and diverse team where there is equal opportunity for all. They admire their senior colleagues who have

worked hard to build successful careers and therefore value their mentorship. They actively want firms to offer mentorship programs to all, to help train them during their careers, and believe that it is in the firms’ interests to give feedback on a regular basis, as this helps junior lawyers progress and contribute to the future success of the firm.

# Litigation costs and third-party funding: avoiding the financial burden for clients

**Susan Dunn**

Harbour Litigation  
Funding, London

susan.dunn@  
harbourlf.com

**W**hen the 2017 Winmark Looking Glass Report survey<sup>1</sup> asked which factors are driving change in the general counsel (GC) role, 69 per cent of respondents quoted cost pressures that require improved efficiency. It is unsurprising, then, that the question, ‘Which factors drive change in the role of external counsel from the GC’s perspective?’ led to 82 per cent respondents answering: ‘Cost pressures that require improved efficiency.’ This was the number one answer.

And yet, costs remain disproportionately high for the administrative aspects of legal service provision.

In our dealings with corporate legal teams, it becomes clear the challenges they face are:

- shrinking budgets (all departments need to deliver savings);
- the need to question and control law firm budgets;
- when it comes to the focus on transactional work, the need to obtain (costly) litigation expertise externally;
- no internal consensus on risk appetite; and
- increased focus on achieving settlement.

Law firms can offer GCs practical solutions when teaming up with a litigation funder. Firms have woken up to the fact that their clients demand that they understand the use of funding. Those embracing this early on have the advantage over slower moving peers.

We have seen an upsurge in direct enquiries from corporates, including from finance departments, approaching us for

assistance with funding and also law firm selection. GCs recognise that we work with an extensive range of firms on all types of disputes and like to tap into our vast networks. They have embraced the fact that third-party funding (TPF) relieves cost pressures while improving efficiency.

## Divergent risk appetite

Chief finance officers (CFOs) and in-house lawyers have different training and mindsets. Accountants are trained to see in black and white, whereas lawyers are accustomed to shades of grey which lack the certainty that someone who works with numbers may crave.

The GC wants to prosecute valid claims and team up with the best legal team. The CFO is less enthused about dedicating part of his limited budget to pursuing litigation. Views of what constitutes ‘acceptable risks’ are divergent. Then, there is the uncertainty about the outcome of litigation or arbitration. We have funded claims that everyone advised we would win, but which either lost or failed to recover any money. Those losses never appeared in the company’s budget because the case was funded.

A CFO is interested in reducing financial risk. Likewise, the GC is trying to reduce legal risk and exposure to claims or criticism for the business. The key step is therefore to stop treating litigation as a liability and transform it into an asset by removing the financial risk of the dispute. This is where TPF is useful.

### Shift the burden of risk

When a funder backs a case, all legal and case-related costs are paid throughout the case by the funder and not by the business. If the case is settled or won and monies received, the funder takes a pre-agreed share of the proceeds. If the case is lost, the loss is the funder's and there is no recourse. The business only pays monies to the funder when it receives monies from a case. TPF allows CFOs to take the legal cost budget off their balance sheets and use that capital for other business objectives, while the GC can pursue good claims.

### Improving efficiencies

Our evaluation of the claim for funding adds an informed second opinion to the prospects of the claim, from our experienced litigators, for no charge.

We help develop and agree the budget for a case. As we ring-fence that budget in our fund at the outset, we make sure all assumptions have been considered. This exercise helps focus the minds of all involved, clearly strategising the objectives for the claim.

TPF also helps strengthen the chances of the case at succeeding by ensuring that the case is properly resourced, that is, that the best legal teams can be appointed.

Corporate clients, and their law firms, may worry they will cede control to the funder when they agree to take on funding. That is not the case: we neither control the litigation team, nor the settlement discussions when they arise.

TPF is a win-win for all parties involved.

#### Note

<sup>1</sup> The Looking Glass Report 2017 by Winmark in partnership with Clyde & Co. The findings are based on a survey of 100 in-house legal leaders and 18 Board directors, desk research and 19 in-depth expert interviews.

#### Caroline Greenwell

Charles Russell Speechlys, London  
caroline.greenwell@crsblaw.com

#### Max Davis

Charles Russell Speechlys, London  
max.davis@crsblaw.com

## Shifting sands and buried treasure: how to uncover key documents and trace monies in complex cases

**O**n 31 May 2018, the Grand Court of the Cayman Islands found in favour of the liquidators of six defendant companies advised by Charles Russell Speechlys in the Islands' longest ever trial (also one of the largest fraud trials ever litigated worldwide), with circa \$9bn damages claimed.

An unusual feature of the ruling in *Ahmad Hamad Algosaihi & Brothers Company (AHAB) v Saad Investment Company Limited and Others*, was that not only were AHAB's business practices found to be dishonest by the Court, but the AHAB partners were found to have been complicit in a US\$330bn Ponzi scheme defrauding international lending banks over decades and specifically in the period from 1980 until the global economic crash in 2008-09.

How were the defendants able to uncover those dishonest business practices and piece

together the story of what actually happened? The answer lies in the use of specialist technology which enabled us, their legal team, to manage, filter and identify the key documents buried in a data set in excess of 2.5 million documents, and trace monies across multiple accounts and jurisdictions over ten years.

### Dealing with high-volume, raw data during discovery

Electronic discovery platforms are not new. Most practitioners will know that even with comparatively small data sets, the ability to sort, filter, search and code by multiple users simultaneously is cost-effective and time-efficient. With a data set over 2.5 million documents (which comprised some

documents that were originally in manuscript and some that were in Arabic and all of which were provided without search functionality or having been pre-sifted for relevance), the platform was essential. It was simply not feasible or proportionate to page-turn every document. The tight trial timetable that the parties were working to made this impracticable, in any event.

The first step, therefore, was to structure and code the dataset so that it could be searchable. To do this, the legal team first had to identify the important characteristics. In this instance, the date, origin (including physical location), author and the extent of foreign language/manuscript content were all vital field codes. Equally vital was the ability to remove exact duplicate documents, without the risk that similar documents (but ones that were found in a different location, for example) would be discarded. It was ultimately the location coding of the documents that enabled the defendants to demonstrate that the claimants knew of and authorised, the practices of which they subsequently claimed to be unwitting victims.

Once the dataset was coded and searchable, the next step was to use the latest available data analytics tools to develop and test the prevailing case theory. This was an iterative process, with both the case theory evolving according to the search results and our search techniques becoming more refined (and ultimately including bespoke algorithms).

For example, ‘seeding’ enables users to identify similar documents based on a key phrase or text structure. This is helpful for identifying groups of similar documents that vary slightly in format over time, like board minutes or other corporate documents. ‘Clustering’ enables users to see which documents regularly appear together or are connected in the dataset. This is useful for establishing which individuals were in regular contact, as well as which documents were sent to whom and with what frequency. This, again, was important in establishing the level of knowledge of the AHAB partners. In any case, where a party’s knowledge is relevant, access to this level of sophistication of data manipulation is incredibly valuable.

### Follow the money: technology and tracing

In order for AHAB to succeed in the claims, they had to show that the defendants received monies belonging to AHAB and knew that they had received these monies.

In outline, tracing in law is a rules-based exercise which requires a claimant to firstly identify his property which has been unlawfully taken and secondly to demonstrate that the property has been used to acquire some other identifiable property (often referred to as a substitute asset). The substitute asset may then have been used to acquire another identifiable asset and so on. One can continue to trace for as long as the chain of substitute assets is unbroken.

One way to defeat a tracing claim is for a defendant to show what actually happened to the money and where it ended up. In some cases that is straightforward but in complex fraud cases, it has previously been nearly impossible. In this case, we were faced with the following challenges:

- The assets were, for the most part, monies moving through bank accounts. The money had been moving for some considerable time and we needed to scrutinise bank and asset statements over a ten year period.
- Given the nature of the various financial businesses there could be hundreds, possibly thousands, of banking entries each day. There were at least ten different parties who disclosed bank and asset statements and each had multiple accounts.
- The transactional dataset was vast. In fact, when all the transactional data was amalgamated there were 65.5 million cells of data.

An automated approach was essential. There was no commercially-available software that could carry out this task. Together with our clients and our data analytics team, therefore, we designed our own bespoke tracing tool.

We employed a reverse tracing exercise, which meant that we looked at specific funds that had been received by the defendants and the tool traced backwards to identify the original source of funds and show that they were not monies that had been misappropriated from AHAB. Using software like this meant that we were able to provide the court with a robust and defensible explanation as to what had become of the monies, supported by expert evidence in court. The use of technology (and the exercise conducted) was subsequently endorsed by the court.

### Key takeaways

- Huge, chaotic datasets are not impenetrable and no longer require time-consuming and costly ‘page-turn’ review.

- The use of technology early in the process can accelerate a merits analysis and allow decisions as to case management strategy, including offers to settle, to be made earlier.
- In any case where assets have been purportedly misappropriated and dispersed through numerous channels, or where the knowledge of a party is in issue, technology can provide you and the court with clarity and certainty.
- The courts are increasingly receptive to technology. The Cayman Islands Court wholeheartedly embraced the use of cutting-edge technology throughout (including entirely new, bespoke technology in this case).
- Cases that were previously considered not commercially viable to proceed to trial (due to the costs of disclosure or the inability to interrogate a dataset manually) may now, in fact, be brought to a successful resolution, provided the legal team has the relevant technological experience and enthusiasm.

## NORTH AMERICA

### Robert Schwinger

Norton Rose Fulbright,  
New York

robert.schwinger@  
nortonrosefulbright.com

### Megan Linares

Norton Rose Fulbright,  
New York

megan.linares@  
nortonrosefulbright.com

# The challenge of trying to fit cryptocurrencies under existing US financial regulatory statutes

There has been an explosion of attention paid to ‘cryptocurrencies’ over the past year or so in the business and financial worlds, and indeed among certain segments of the general public. Cryptocurrencies, also known as virtual currencies, are digital assets designed to work as a medium of exchange, but which are controlled through cryptography and encryption techniques using blockchain and distributed ledger technology, so that they can function on a decentralised basis independently of a central bank. There are now more than 1,500 known cryptocurrencies, the most well-known of which is Bitcoin.

Because of the increasing activity in and attention to the cryptocurrency space, legal issues and disputes involving cryptocurrencies have begun to mount. One of the questions that United States courts face when such disputes arise is whether cryptocurrency falls under any existing US legal structures of financial regulation. Two recent New York federal court cases examine whether cryptocurrencies are subject to two of the major US statutory regimes for financial products, the commodities laws and the securities laws.

### Treating cryptocurrencies as commodities

A March 2018 decision in *Commodity Futures Trading Commission v McDonnell*<sup>1</sup> (‘*McDonnell*’) examined an attempt by the US Commodity Futures Trading Commission (CFTC) to bring an enforcement action involving cryptocurrencies under the US Commodities Exchange Act (CEA).<sup>2</sup> The CFTC in *McDonnell* alleged that defendants offered fraudulent trading and investment services related to cryptocurrencies. The CFTC charged that customers paid the defendants for ‘memberships’ in virtual currency trading groups, with the defendant purporting to provide exit prices and profits. However, the CFTC charged that, after receiving membership payments and virtual currency investments, the defendants deleted websites, ceased communication, provided minimal, if any, virtual currency trading advice and did not follow through with the promised return on investment. Moreover, when customers asked for a return of their membership fees or virtual currency investments, the defendants refused and misappropriated funds.

The defendants challenged the CFTC’s right to proceed against them under the

CEA's anti-fraud provisions, arguing that virtual currencies were not 'commodities' subject to the CEA's regulatory structure. The court, noting that 'virtual currencies are generally defined as "digital assets used as a medium of exchange,"' neatly identified the conundrum posed by the defendants' challenge by observing that virtual currencies 'have some characteristics of government paper currency, commodities, and securities.' While the CFTC and other US federal agencies claim concurrent regulatory power over virtual currency in certain settings, they, at the same time, 'concede their jurisdiction is incomplete.' Moreover, 'Congress has yet to authorise a system to regulate virtual currency.'

The court noted that commentators have offered various rationales for why virtual currencies should be viewed as 'commodities': 'based on common usage'; 'because virtual currencies provide a "store of value"'; and 'because they serve as a type of monetary exchange'. Surveying the development of online marketplaces for trading and investing in virtual currencies, the court also observed that 'legitimation and regulation of virtual currencies has followed from the CFTC's allowance of futures trading on certified exchanges.'

Ultimately, the court looked to the CEA's definition of a 'commodity',<sup>13</sup> which covers not just various agricultural articles but also 'all services, rights, and interests [...] in which contracts for future delivery are presently or in the future dealt in.' The statute's reference to 'services, rights and interests' encompasses even 'intangible commodities.' Thus, the court concluded, 'where a futures market exists for a good, service, right, or interest, it may be regulated by CFTC, as a commodity, without regard to whether the dispute involves futures contracts.' Therefore, under the CEA's anti-fraud provisions, the CFTC's enforcement powers extend 'to fraud related to spot markets underlying the (already regulated) derivative markets.' Accordingly, the court held that cryptocurrencies 'can be regulated by CFTC as a commodity,' because they 'are "goods" exchanged in a market for a uniform quality and value, and thus fall well-within the common definition of commodities.'

The *McDonnell* decision is the first US federal judicial endorsement of the CFTC's position that it has jurisdiction over a cryptocurrency under the US commodities laws. While the court in *McDonnell* acknowledged that the CFTC has 'exclusive jurisdiction over transactions conducted on

futures markets,' the court did not go so far as to hold that the CFTC had exclusive authority over all issues relating to virtual currencies. Noting possible regulatory roles for such bodies as the US Department of Justice, the US Securities and Exchange Commission (SEC), the US Treasury Department's Financial Enforcement Network (FinCEN), the US Internal Revenue Service (IRS), private exchanges and individual US states, the court cautioned that the 'authority of CFTC to regulate virtual currencies as commodities does not preclude other agencies from exercising their regulatory power when virtual currencies function differently than derivative commodities.'

### Treating cryptocurrencies as securities

Another case now pending in the same federal court (but before a different judge) poses the question of whether cryptocurrencies in proper circumstances can be subject to the US securities laws. The head of the US SEC has asserted that 'some products that are labelled cryptocurrencies have characteristics that make them securities,' in which case "[t]he offer, sale and trading of such products must be carried out in compliance with securities law.' The court,<sup>4</sup> in a now-pending criminal securities prosecution, *US v Zaslavskiy (Zaslavskiy)*<sup>5</sup> is determining just that — whether or not the cryptocurrency used by the defendant has characteristics and functions essentially like those of securities, such that it is subject to the provisions of the US securities laws. While the court has not yet ruled on the issue, the briefs of the defendant and the government set forth competing arguments on each side of the issue.

*Zaslavskiy* involved an alleged scheme to market investments in an initial coin offering (ICO) in which purchasers would obtain cryptocurrency 'tokens' allegedly backed by sophisticated real estate investments run by lawyers, brokers and developers that would increase the tokens' value. The government charged that, among other problems, there were in fact no real estate professionals involved, no real estate was ever purchased or even researched, token values would thus never increase and that indeed no tokens were ever developed. The defendants later shifted their supposed offering to one allegedly backed by diamonds where, once again, there were no experts, no diamonds purchased, and no tokens, according to

the government. Alleging that these ICOs involved ‘investment contracts’ and thus ‘securities’ under the US securities laws, the government indicted the defendant for securities fraud.

The defendant moved to dismiss the indictment. He argued that because a cryptocurrency is a digital representation of value that can be digitally traded and functions as a medium of exchange, it is therefore a currency, but the US securities laws specifically provide that the term ‘security’ as used in those statutes ‘shall not include currency,’ and thus the term ‘security’ cannot extend to cryptocurrencies.<sup>6</sup>

The defendant also argued that its cryptocurrency fails the United States Supreme Court’s long-established test for determining whether certain transactions qualify as an ‘investment contracts’ and thus ‘securities,’ known as the Howey test,<sup>7</sup> and for that additional reason he could not be prosecuted under the US securities laws.<sup>8</sup> Howey set forth a three-part test under which, in order to qualify as an ‘investment contract’ and thus a ‘security,’ there must be: an investment of money, in a common enterprise, with profits to be derived solely from the efforts of others.<sup>9</sup> The defendant contended that none of Howey’s elements were met in his case: there was no investment of money, rather an exchange of one medium currency for another; no pooling of assets or pro-rata distribution of profits; and the currency’s value was derived from a number of sources, not just the ‘managerial efforts of others.’ Specifically, the defendant argued that the decentralised nature of a blockchain-based system makes all participants in the system contributors to the creation of value, including the token purchaser.<sup>10</sup>

Lastly, the defendant argued that the government’s attempt to ‘regulate this new asset class using the framework conceived of in the 1930s is troubling,’ and that using such laws in that context was unconstitutionally vague and would result in arbitrary enforcement and inconsistent criminal prosecutions.<sup>11</sup>

In response, the government disputed each of these points. It argued that despite the use of the term ‘cryptocurrency,’ what matters is not the name but its economic substance. The government argued that cryptocurrency is not a ‘currency’ because it does not circulate as a medium of exchange, generally accepted as payment in a transaction, nor is it recognised as a standard of value.<sup>12</sup>

Rather, the government contended, the defendant’s cryptocurrency is a ‘security’ which passes the three-part Howey test. The investors paid money to participate in a common enterprise, the basis of which was that investors’ assets would be pooled to invest in real estate and diamonds, and that there would be shared profits derived from the managerial efforts of the defendant and his co-conspirators, and the supposed expertise of the teams they would assemble. The investors’ role reasonably expected to be primarily passive and not deriving solely from the operation of a blockchain ‘ecosystem.’<sup>13</sup>

The government also rejected the defendant’s vagueness argument. It pointed out case law developed under the securities statutes, such as Howey, clearly define, explain and outline the definition of securities and investment contracts and therefore provided sufficient notice that the defendant’s conduct constituted securities fraud. The SEC has issued reports announcing its position that cryptocurrencies can be regulated as ‘securities.’ Moreover, functional tests like the Howey test developed under the securities laws are designed to enable those laws to adapt to govern new types of financial products as they arise.<sup>14</sup>

The SEC filed a brief in support of the government’s position and echoing most of its arguments, which also discussed the importance of treating cryptocurrencies as ‘securities.’ The SEC noted that billions of dollars in capital have been raised in recent years through ICOs and contended that a majority of ICO fundraising is unlawfully conducted through unregistered and fraudulent offerings of securities. For this reason, the SEC argued, it is important that such offerings be regulated by the securities laws.<sup>15</sup>

In its reply brief, the defendant countered the government’s argument that cryptocurrencies do not circulate as a medium of exchange by citing the recent *McDonnell* decision where the court expressly noted that ‘virtual currencies are generally defined as “digital assets used as a medium of exchange,”’ and stressed that, in this case, that is precisely how those cryptocurrencies were marketed.<sup>16</sup>

The defendant’s motion to dismiss the indictment in *Zaslavskiy* is awaiting decision at this time. It is likely to be the first judicial ruling on whether a cryptocurrency offering can be deemed a ‘security’ subject to the US securities laws.<sup>17</sup>

## Observations

Neither the court's ruling in *McDonnell* nor the government's briefing in *Zaslavskiy* attempts to advance a preclusive determination for all cases about whether all cryptocurrencies should be regarded as a 'commodity' and/or a 'security' for the purposes of US law. Rather, in each instance, the arguments in support of such conclusions tend to be tied to the particular facts of each situation, with no attempt to foreclose regulation under other bodies of law as may be appropriate. Unless and until the US develops specific cryptocurrency regulatory legislation, this cautious and conservative approach may be the way US courts will need to proceed in disputes involving cryptocurrencies where governmental or private parties attempt to invoke existing regulatory frameworks that were developed in different contexts.

### Notes

- 1 287 F. Supp. 3d 213 (E.D.N.Y. 2018).
- 2 7 U.S.C. § 1 *et seq.*
- 3 7 U.S.C. § 1a(9).
- 4 Jay Clayton & Christopher Giancarlo, 'Regulators are Looking at Cryptocurrency' *Wall Street Journal* (24 January 2018).

- 5 *United States v Zaslavskiy*, No. 1:17-cr-00647 (E.D.N.Y. filed 21 November 2017). There is also a related SEC civil enforcement proceeding in the same court, *SEC v RECoin Group Foundation, LLC et al.*, No. 17-cv-05725 (E.D.N.Y. filed 29 September 2017).
- 6 See Defendant's Motion to Dismiss, *United States v Zaslavskiy* (filed 27 February 2018), 6-10.
- 7 *SEC v W.J. Howey Co.*, 328 U.S. 293 (1946).
- 8 See Defendant's Motion to Dismiss, *United States v Zaslavskiy* (filed 27 February 2018), 10-17.
- 9 *Howey*, 328 U.S. at 298-301; see also *SEC v Edwards*, 540 U.S. 389, 393 (2004).
- 10 See Defendant's Motion to Dismiss, *United States v Zaslavskiy* (filed 27 February 2018), 15-16.
- 11 *Idem* 18-23.
- 12 See Government's Memorandum in Opposition to Motion to Dismiss, *United States v Zaslavskiy* (filed 19 March 2018), 24-28.
- 13 *Idem* 10-24.
- 14 *Idem* 28-34.
- 15 See SEC's Brief in Support of the United States' Opposition to Motion to Dismiss, *United States v Zaslavskiy* (filed 19 March 2018).
- 16 See Defendant's Reply Brief in Support of Motion to Dismiss, *United States v Zaslavskiy* (filed 26 March 2018), 2-6.
- 17 There is another just-filed US private civil class action lawsuit that has received much attention which likewise raises the question of whether a cryptocurrency should be regarded as a security, in a case charging that Ripple Lab's XRP tokens should be treated as an offering of unregistered securities in violation of federal and California securities laws. *Coffey v Ripple Labs, Inc. et al.*, No. 3:18-cv-03286 (U.S.D.C. N.D. Calif., filed in Calif. Super Ct., San Fran. Cty. 3 May 2018, removed to federal court 1 June 2018).

# 'Libel tourism' and Canadian private international law conflicts rules in multi-jurisdictional internet defamation claims: *Haaretz.com v Goldhar*, 2018 SCC 28

**Chidinma Thompson**

Borden Ladner Gervais,  
Calgary  
cthompson@blg.com

**M**ulti-jurisdictional defamation claims are not new, but the exponential increase in multi-jurisdictional internet publications has led to a growing concern about 'libel tourism' and the possible assumption of jurisdiction by an unlimited number of forums.

A two-stage analysis required for Canadian courts to assume and exercise jurisdiction

in a multi-jurisdictional civil claim are the *jurisdiction simpliciter* doctrine and the *forum non conveniens* doctrine. These doctrines, along with those relating to the recognition of foreign judgments, represent the common law conflicts rules of Canadian private international law.

The Supreme Court of Canada has clarified the distinct roles played by the *jurisdiction*

*simpliciter* and *forum non conveniens* doctrines in order to maintain the principles underlying Canadian private international law conflicts rules. The clarified legal tests will guide Canadian Courts in assuming and exercising jurisdiction in multi-jurisdictional internet defamation claims and will afford litigants and lawyers some measure of certainty in Canada as a potential forum for such actions.

### The facts

The Respondent, Goldhar, is a prominent Canadian businessman who owns and operates SmartCentres Inc. in Ontario and also owns one of the most popular professional soccer teams in Israel, the Maccabi Tel Aviv Football Club ('Maccabi Tel Aviv'). Goldhar, who has been described as a celebrity in Israel, maintains a residence in Israel and visits every few months. The Appellants, Haaretz.com, Haaretz Daily Newspaper Ltd, Haaretz Group, Haaretz.co.il, Shlomi Barzel and David Marouani (collectively, 'Haaretz'), are Israel's oldest daily newspaper published in both English and Hebrew, online and in print. In 2011, Haaretz published an article, in print and electronically in Hebrew and English, about Goldhar's ownership and management of Maccabi Tel Aviv. The article alleged that his management model was imported directly from his Canadian business. The article was researched, written and edited in Israel, primarily with reliance on Israeli sources. While it was not distributed in print in Canada, it was available electronically. About 200 to 300 people in Canada and 70,000 people in Israel read the article. Goldhar commenced an action for libel in Ontario, alleging damage to his reputation. Haaretz brought a motion to stay the Ontario action, arguing that the Ontario courts lacked jurisdiction or, alternatively, that Israel was a more appropriate forum.

The motion judge dismissed the motion, finding that the Ontario courts had jurisdiction and refused to decline to exercise this jurisdiction in favour of Israeli courts. The motion judge relied on two undertakings by Goldhar's counsel, namely, that Goldhar would not seek damages for reputational harm suffered in Israel or anywhere else outside of Canada, and that Goldhar would pay for the travel and accommodation expenses of Haaretz's witnesses at the rates provided in the Ontario Rules of Civil Procedure. The majority of the Court of Appeal dismissed Haaretz's appeal.

### The issues

The main issue on appeal to the Supreme Court of Canada was whether the motion judge erred in assuming jurisdiction and in finding that Israel was not a more appropriate forum than Ontario. Of particular contention were the appropriate roles of the two doctrines and their constituent factors in internet defamation cases. The Supreme Court of Canada had to determine, in internet defamation claims, for the *jurisdiction simpliciter* analysis: 1. whether the situs of the tort is a reliable basis to presume a 'real and substantial connection' between the chosen forum and subject matter of litigation; 2. under what circumstances, if any, the presumption of jurisdiction can be rebutted; and, for the *forum non conveniens* test, 3. whether the choice of law factor should be based on the place where the plaintiff suffered most substantial harm to their reputation (the most substantial harm principle) rather than the law of the place where the tort was committed (*the lex loci delicti* principle).

### The decision

In a 6:3 split decision, a majority of the Supreme Court of Canada (the 'majority'), allowed the appeal and granted Haaretz's motion to stay the action in Ontario.

### The context

Central to the conflicts rules of Canadian private international law are the *jurisdiction simpliciter* analysis, which first ensures that a court has jurisdiction, and the *forum non conveniens* analysis, which then guides courts in deciding whether to decline to exercise established jurisdiction in favour of a 'clearly more appropriate' forum. Each analysis has underlying principles and relevant factors to be considered. The *jurisdiction simpliciter* analysis considers a 'real and substantial connection' between a chosen forum and the subject matter of the litigation. It establishes a minimum threshold and prioritises order, stability and predictability by relying on a set of defined, objective, presumptive connecting factors for the assumption of jurisdiction that is consistent with the principle of comity. Conversely, the *forum non conveniens* analysis delineates the circumstances in which a court should exercise or decline to exercise established jurisdiction. It emphasises fairness

and efficiency by adopting a flexible case-by-case approach to identify whether an alternative jurisdiction may be 'clearly more appropriate' given that jurisdiction may sometimes be established on a low threshold. The *forum non conveniens* analysis considers factors such as: comparative convenience and expense for the parties; comparative convenience and expense for the witnesses; loss of legitimate juridical advantage; fairness; enforcement; and the applicable law or choice of law.

### Stage 1: *jurisdiction simpliciter*

At the *jurisdiction simpliciter* stage, to determine whether a 'real and substantial connection' exists between a chosen forum and the subject matter of the litigation, courts are required to consider: 1. the existence of a recognised presumptive connecting factor; and 2. whether the party challenging the jurisdiction has successfully rebutted the presumption. The recognised presumptive connecting factors grounding a court's assumption of jurisdiction in Canada are: 1. whether the defendant is domiciled or resident in the province; 2. whether the defendant carries out business in the province; 3. whether the tort was committed in the province; and 4. whether a contract connected with the dispute was made in the province.

Generally, the strict liability tort of defamation is committed where material has been 'communicated to' (conveyed to and received by) at least one person other than the plaintiff. In internet communications, the publication of defamatory statements occurs when they are read or downloaded by the recipient. Accordingly, the situs of internet-based defamation is the place where the defamatory statements are read, accessed or downloaded by the third party.

On the first issue, Haaretz argued that the situs of the tort is an unreliable basis to presume a 'real and substantial connection' in internet defamation cases and that the ease with which publication can be established in such cases gives rise to only a weak relationship with the chosen forum. The majority rejected this argument and confirmed that the situs of the tort is an appropriate connecting factor in internet defamation cases. They reasoned that raising doubt as to the validity of this factor as a presumptive connecting factor would significantly undermine the underlying objectives of predictability and order at the

*jurisdiction simpliciter* stage. Therefore any concerns relating to the insufficiency of a presumptive connecting factor should be addressed either at the rebuttal stage of the *jurisdiction simpliciter* analysis or at the *forum non conveniens* stage. The majority concluded that Goldhar has established a presumptive connecting factor with Ontario in the circumstances of this case.

On the second issue of rebuttal of the presumption, the majority recognised the ease with which a presumptive connecting factor may be established in internet defamation cases and the need for a check on such 'virtually automatic' jurisdiction. They held that presumptive connecting factors must not give rise to an irrebuttable presumption of jurisdiction. Accordingly, a careful examination of a rebuttal is of particular importance in internet defamation cases. The majority held that for a defendant to succeed in showing that a given connection is inappropriate, it must be shown that the relationship between the forum and the subject matter of the litigation is such that it would 'not be reasonable to expect that the defendant would be called to answer proceedings in that jurisdiction.' They held that, while it is inappropriate to propose an exhaustive list of factors that can rebut the presumption of jurisdiction in these types of cases, examples abound, such as where a plaintiff has no reputation in the chosen forum. Absence of reputation may be a factor to rebut the presumption, as it points to a weak relationship between the forum and the subject matter of the litigation. However, the majority cautioned that the *forum non conveniens* factors should not be worked into this rebuttal stage of the *jurisdiction simpliciter* analysis. They concluded that Haaretz had failed to establish that it could not have reasonably expected to be called to answer a legal proceeding in Ontario and therefore had not rebutted the presumption of jurisdiction.

### Stage 2: *forum non conveniens*

At the *forum non conveniens* stage, the burden is on the defendant to satisfy the motion judge that the alternative forum is 'clearly more appropriate' by establishing that it would be fairer and more efficient to proceed in that forum. The majority held that while the normal state of affairs favours exercising jurisdiction in the forum

where it is properly assumed, this should never come at the cost of one party facing unfair or clearly inefficient proceedings. Accordingly, a motion judge must conduct a robust and carefully-scrutinising review of the issue of *forum non conveniens*, given that the establishment of a presumptive connecting factor is 'virtually automatic' in internet defamation cases and that the rebuttal stage of the *jurisdiction simpliciter* analysis fails to address all the consequences of such 'virtually automatic' presumption of jurisdiction. For example, where a plaintiff enjoys a reputation in multiple forums and publication may allow jurisdiction to be properly assumed in all of them, motion judges should be particularly attuned to concerns about fairness and efficiency at the *forum non conveniens* stage. However, this does not impose a different standard or burden for defamation cases.

On the last issue, the majority confirmed *lex loci delicti* as the general principle for determining the choice of law factor. It also confirmed that there may be exceptions where a possible alternative principle may be the 'place of most substantial harm' to reputation (potentially the tort of libel). However, the current case was not an appropriate one to adopt the proposed 'place of most substantial harm' principle. The majority noted that, in this case, the most substantial harm test would not have clearly favoured either forum, as the evidence did not allow for a determination as to where Goldhar enjoyed the most substantial reputation, or where the most substantial harm to that reputation occurred. Without discouraging the determination of the issue in the future, however, the majority cautioned against making such changes to the existing private international law framework that may create legal uncertainty. The majority ultimately concluded that the choice of law factor as determined by the *lex loci delicti* principle should be accorded little weight in the *forum non conveniens* analysis in cases where jurisdiction is established on the basis of the situs of the tort. Accordingly, the applicable law factor is of little value in determining whether an alternative forum is clearly more appropriate in internet defamation cases.

The *forum non conveniens* analysis being inherently factual in nature, a motion judge's factual findings is entitled to deference unless the motion judge erred in principle, misapprehended or failed to consider material evidence, or reached

an unreasonable decision. The majority concluded in this case that the motion judge made several errors that tainted this stage of the analysis. The errors related to the comparative convenience and expense for the witnesses, compellability of unwilling Israeli witnesses by letters rogatory, fairness and enforcement factors. The majority found that the comparative convenience and expense for the witnesses favoured Israel, fairness favoured Israel and enforcement slightly favoured Israel. Loss of legitimate juridical advantage and applicable law, while favouring Ontario, did not weigh heavily in the analysis. The majority concluded that that Haaretz would face substantial unfairness and inefficiency if a trial were held in Ontario and Goldhar's interest in vindicating his reputation in Ontario did not outweigh these concerns.

### The implications

Canadian courts, litigants and lawyers all have lessons from the Supreme Court of Canada's analysis to take from case. Courts are now better guided in assuming and exercising jurisdiction in multi-jurisdictional internet defamation claims. For litigants and their lawyers, the following are noteworthy in commencing or defending internet defamation claims.

**The scope of the claim:** the majority noted that any consideration of the *jurisdiction simpliciter* and *forum non conveniens* analyses is dependent on the scope of the claim. Goldhar wanted a trial in Ontario. His claim should have been limited to libellous statements pertaining to his Canadian business or damage to his Canadian reputation.

**The content of the pleadings:** the claim or defence must be drafted to fit the elements to be proved. The majority found a lot of inconsistencies with Goldhar's pleadings and his subsequent arguments. For example, the pleadings confirmed that Goldhar saw himself as enjoying a significant reputation in Israel. On this basis, the majority rejected the argument that Goldhar was particularly concerned about the impact on his Canadian business reputation or that the sting of libel relates to his reputation in Ontario. Furthermore, the pleadings referred only to Maccabi Tel Aviv in Israel and did not mention SmartCentres Inc. in Ontario. While it set out the alleged factual errors and fabrications pertaining to his management of Maccabi Tel Aviv, the pleadings failed

to identify or connect any such errors or fabrications relating to Goldhar's Canadian business. The pleadings particularly failed to mention the article's claim about Goldhar's management model imported directly from his main business interest in Canada, which provided the connection between the allegedly libellous statements and Goldhar's Canadian business reputation. Finally, in describing the damage he suffered, the pleadings stated that Goldhar conducts business in Israel, Canada and the United States. Canada was never singled out as the forum where reputational harm has been suffered for the purposes of this action.

**Evidence:** the quality of evidence for the *forum non conveniens* analysis is critical and requires the parties to put their best foot forward. While there was ample evidence of Goldhar's significant business interest and reputation in Israel, not so much in respect of Canada. Goldhar did not file any evidence regarding the witnesses he would call at trial. Haaretz filed a list of 22 witnesses (18 resided in Israel) and described in its factum what each of the witnesses may speak to. Haaretz also filed a supplemental affidavit that described the evidence that 8 of these witnesses could give to assist Haaretz at trial. While Goldhar filed an expert opinion to the effect that many of Haaretz's witnesses did not have relevant evidence, the majority held that, in a *forum non conveniens* analysis, expert opinion

is inadmissible to raise doubt as to the relevance of a proposed witness' testimony, as only a motion judge can make such determinations. Haaretz also led evidence to the effect that many of its witnesses would not voluntarily testify and that these witnesses could not be compelled directly to attend a trial in Ontario. The majority found that whether Israel would actually enforce letters rogatory was a crucial issue requiring expert evidence, but Goldhar did not provide evidence on this issue.

**Parties' undertakings:** undertakings to fit the desired forum may be worthless, especially if they do not bar actions in other jurisdictions. Goldhar undertook to seek damages in the Ontario action only for reputational harm suffered within Canada. The majority held that such undertaking did not narrow the scope of Goldhar's pleadings. Furthermore, failure of the undertaking to preclude a future action in Israel to recover damages detracts from a relevant consideration, namely, the avoidance of a multiplicity of legal proceedings and conflicting decisions. In addition, Goldhar's undertaking to fund the travel and accommodation expenses of Haaretz's foreign witnesses was also rejected. The majority held that consideration of such an undertaking would allow a wealthy plaintiff to sway the *forum non conveniens* analysis, which would be inimical to the underlying principles of fairness and efficiency.

## The US crime-fraud exception to the attorney-client privilege

**Thomas Hall**

Norton Rose Fulbright,  
New York

thomas.hall@  
nortonrosefulbright.com

**T**he recent seizure by United States federal agents of documents in the possession of President Trump's personal lawyer, Michael Cohen, has generated much press and speculation concerning the scope of protection over those documents afforded by the attorney-client privilege. While many of those documents are reportedly unrelated to Cohen's representation of President Trump, there has been speculation that some of the investigators' focus is on possible campaign

contribution violations. Reports of a \$130,000 payment allegedly made by Cohen to an adult film actress to obtain her silence could perhaps provide grounds for the assertion of such violations, depending on the source of those funds. In that event, according to continued press speculation, otherwise privileged communications between Trump and Cohen may lose their privileged status, should the court decide that the crime-fraud exception applies to documents dealing with that payment and the source thereof.

### The US attorney-client privilege

The attorney-client privilege is the oldest privilege recognised by the Anglo-American system of jurisprudence, its use being firmly established in English law as of the 16th century. Grounded in the concept of honour, the privilege works to bar any testimony by the attorney against the client. The attorney-client privilege has been defined in the US as follows: ‘(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his [or her] capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his [or her] instance permanently protected (7) from disclosure by [the client] or by the legal adviser, (8) except the protection be waived.’<sup>2</sup>

At bottom, the privilege ensures ‘that one who seeks advice or aid from a lawyer should be completely free of any fear that his secrets will be uncovered’. The principle underlying the privilege is for the attorney to provide ‘sound legal advice [and] advocacy’.<sup>3</sup> With the protection of the privilege, the client can speak openly with counsel, disclosing all relevant information and creating a zone of privacy. Shielded by the privilege, the client may be more willing to communicate to counsel things that might otherwise be suppressed. By promoting such candour and honesty, the attorney can provide more accurate advice and the client can be secure in the knowledge that statements to the lawyer will not be used against his or her interest.

Under the protection of the privilege, the attorney may neither be compelled to, nor may he or she voluntarily disclose matters conveyed in confidence to him or her by the client for the purpose of seeking legal counsel. Likewise, the client may not be compelled to testify regarding communications with the lawyer for the purpose of seeking legal counsel.

### The crime-fraud exception

Communications that would otherwise be protected by the attorney-client privilege generally are not protected in the US if they relate to client communications in furtherance of contemplated or ongoing criminal or fraudulent conduct. The rationale of the exception is that the privilege protects the provision of sound legal advice, but advice in furtherance of a fraud or illegal goal cannot be considered ‘sound’. Rather,

it is socially perverse and the client’s communications seeking advice do not merit protection. Because the client and lawyer become instruments of a crime or fraud, their communications are no longer sacrosanct.

To establish the crime-fraud exception under US law, a party must demonstrate that there is probable cause to believe that a fraud or crime has been committed and that the communications in question were in furtherance of the crime or fraud. Probable cause is the equivalent of ‘a reasonable basis for believing that the objective was fraudulent’.<sup>6</sup> This ‘require[s] that a prudent person have a reasonable basis to suspect the perpetration or attempted perpetration of a crime or fraud, and that the communications were in furtherance thereof’.<sup>7</sup> The criminal or fraudulent nature of the objective need not be conclusively established for the crime-fraud exception to apply; demonstrating a reasonable basis for believing that the objective was criminal or fraudulent may be adequate. A reasonable basis to suspect the perpetration or attempted perpetration of a crime or fraud may be demonstrated by a showing that the client was engaged in planning a wrongful scheme when seeking advice from counsel, or committed or attempted to commit a crime or fraud after receiving the benefit of counsel’s work.<sup>8</sup>

Communications in furtherance of the crime or fraud are those that reasonably relate to the subject matter of the crime or fraud<sup>9</sup> or have some relationship between the communication at issue and the prima facie violation.<sup>10</sup> That is, there must be ‘purposeful nexus’ between the communications at issue and the criminal or fraudulent activity as opposed to mere ‘temporal nexus’.<sup>11</sup> Probable cause for the application of the crime-fraud exception may be found without a finding that the attorney had criminal or fraudulent intent.<sup>12</sup>

### Privileged communications outside the US

When privileged communication takes place in a country outside the US, US courts generally defer ‘to the law of the country that has the “predominant” or “the most direct and compelling interest” in whether those communications should remain confidential, unless that foreign law is contrary to [US] public policy’.<sup>13</sup> ‘[U]nder this test, communications that relate to activity in a foreign country are governed by that country’s privilege law, while communications

that “touch base” with the United States are controlled by United States privilege law.<sup>14</sup>

One US court has noted that ‘the communications in dispute do not touch base with the United States and thus United States privilege law does not apply to these documents. As these communications clearly “relate to activity in a foreign country [they] are governed by that country’s privilege law,” which in this instance is the law of Sweden’.<sup>15</sup> Finally, ‘[t]he party invoking a foreign privilege has the burden of proving the applicability of the foreign law and must establish that the foreign law protects the communication from discovery. The burden then shifts to the opponent of the privilege to present evidence to contest the existence of the privilege’.<sup>16</sup>

**Notes**

- 1 Edna Selan Epstein, *The Attorney-Client Privilege and the Work-Product Doctrine*, 2 (4th Ed. 2001).
- 2 8 John Henry Wigmore, *Evidence In Trials At Common Law*, § 2292 at 554 (McNaughton 1961 & Supp. 1991).

- 3 *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).
- 4 Cathryn M. Sadler, *The Application of the Attorney-Client Privilege to Communications Between Lawyers Within the Same Firm: Evaluating United States v. Rowe*, 30 Ariz. St. L. J. 859, 859 (1998).
- 5 *In re Grand Jury Subpoena Duces Tecum Dated September 15, 1983*, 731 F.2d 1032, 1038 (2d Cir. 1984); see *United States v. Jacobs*, 117 F.3d 82, 87 (2d Cir. 1997); *John Doe, Inc. v. United States*, 13 F.3d 633, 636 (2d Cir. 1994).
- 6 *United States v. Jacobs*, 117 F.3d at 87 (2d Cir. 1997); *John Doe, Inc. v. United States*, 13 F.3d at 637; *S.E.C. v. Herman*, No. 00-5575, 2004 WL 964104, at \* 2 (S.D.N.Y. May 5, 2004).
- 7 *In re Grand Jury Subpoena Duces Tecum Dated September 15, 1983*, 731 F.2d at 1039.
- 8 *In re Sec. Litig.*, 148 F.R.D. 91, 100 (S.D.N.Y. 1993).
- 9 *In re Bairnco Sec. Litig.*, 148 F.R.D. 91,100 (S.D.N.Y. 1993).
- 10 *In re Sealed Case*, 754 F.2d 395, 402 (D.C. Cir. 1985).
- 11 *In re Grand Jury Subpoenas Duces Tecum*, 798 F.2d 32, 34 (2d Cir. 1986).
- 12 *Clark v. United States*, 289 U.S. 1,15 (1933); *In re Sealed Case*, 754 F.2d 395, 402 (1st Cir. 1985); *S.E.C. v. Herman*, 00 Cv. 5575, 2004 WL 964104, at \*2.
- 13 *Astra Aktiebolag v. Andrx Pharm., Inc.*, 208 F.R.D. 92, 98 (S.D.N.Y. 2002).
- 14 *AstraZeneca LP v. Breath Ltd.*, CIV. 08-1512, 2011 WL 1421800, at 3 (D.N.J. Mar. 31, 2011).
- 15 *Id.*
- 16 *Cadence Pharm., Inc. v. Fresenius Kabi USA, LLC*, 13-CV-00139, 2014 WL 370132, at \*3 (S.D. Cal. Feb. 3, 2014) (internal citations omitted).

# US Supreme Court: foreign government’s construction of its national law gets ‘respectful consideration’ but not the last word

**David Jacoby**  
 Culhane Meadows,  
 New York  
 djacoby@  
 culhanemeadows.com

The United States Supreme Court ruled unanimously at the end of its recent term that a foreign nation’s statement of what its law means is not entitled to obligatory deference in American federal courts, although it does deserve ‘respectful consideration.’ *Animal Science Products, Inc. v Hebei Welcome Pharmaceutical Co.*, 585 US \_\_\_ 2018 US LEXIS 3684 (14 June 2018).

**Context of the decision**

The ruling arose in a multi-district antitrust litigation over asserted price-fixing involving Chinese Vitamin C exports to the United

States. In the District Court, defendant sellers asserted they were bound by Chinese law to fix Vitamin C prices and quantities for export. On that basis, among others, the defendants first sought dismissal of, and then later summary judgment on, the Sherman Act claims against them.

In a first-ever action, the Ministry of Commerce of the People’s Republic made an appearance in the federal court and filed an *amicus curiae* submission. The Ministry’s brief supported the defendants’ position that they had followed a ‘regulatory pricing regime mandated by the government of China’.

The trial court denied both motions by the defendants. After trial, the jury returned a verdict in favour of the plaintiffs of \$147m after trebling and the District Court also granted an injunction against further violations.

On appeal, the New York-based US Court of Appeals for the Second Circuit, which often hears matters involving foreign parties, reversed. In a long opinion analysing international comity issues, the Second Circuit held that when a foreign government participates in a US court proceeding and provides a 'reasonable' understanding of the meaning of that country's domestic laws, the American court must defer to that interpretation.

### High Court ruling

The Supreme Court reversed the Second Circuit's decision. Justice Ruth Bader Ginsburg's opinion for a unanimous bench acknowledged that at common law and then initially under the Federal Rules of Civil Procedure, a determination of foreign law had been treated as a matter of fact, subject to proof. However, with the adoption of Federal Rule of Civil Procedure (FRCP) 44.1 in 1966, such determinations had become questions of law.

FRCP 44.1 provides in part: 'In determining foreign law, the court may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence. The court's determination must be treated as a ruling on a question of law.' Treating the determination as one of law has a further significance, in that appellate review will be *de novo*, and not under a clearly erroneous standard.

As Justice Ginsburg's opinion observed: 'Given the world's many and diverse legal systems, and the range of circumstances in which a foreign government's views may be presented, no single formula or rule will fit all cases in which a foreign government describes its own law.' (Slip Opinion at 9.) The Court's non-exhaustive list of factors that can be considered includes the foreign government statement's clarity, thoroughness and support; its context and purpose; how transparent the foreign legal system is; the role and authority of the entity or official offering the statement; and the statement's consistency with the foreign government's past positions. (Slip Opinion at 9.)

The Court distinguished a 76-year-old Second World War case where the view

of a Soviet ministry on the scope of state expropriation of a Russian insurance company's property had been obtained by the US Government through diplomatic channels. The ministry's statement had been treated as conclusive, but there had been nothing inconsistent with regard to the foreign government's interpretation. (Slip Opinion at 10-11.) The Court further noted that, historically, the United States Government has not urged foreign courts to find that its interpretation of American law was binding on them. Moreover, two international conventions take the same view, although the US is not party to either one. (Slip Opinion at 12.)

Justice Ginsburg observes that the treatment of foreign government statements about the meaning of their laws now adopted by the Supreme Court puts them on the same footing as an American state government's statements as to the meaning of its laws. While a decision of an American state's highest court on that state's law binds federal courts, a statement by, for example, its Attorney General, does not. (Slip Opinion at 9.) Accordingly, the Supreme Court remanded the *Vitamin C* case for further consideration in light of its opinion.

Although high court judges sometimes are accused of being out of touch with facts on the ground, Justice Ginsburg's opinion suggests a keen awareness of how parties in litigation – even governments – can tailor their positions and be highly selective to further their ends. Thus, the opinion notes that the People's Republic of China previously had made an inconsistent statement to the World Trade Organisation, contending that it had abandoned export administration of Vitamin C in 2001, which flatly contradicted the position the Ministry of Commerce had taken in its *amicus* brief in the District Court. To put the effect of the holding more colloquially, if less diplomatically: trust everyone, but cut the deck.

### Notes

- In re Vitamin C Antitrust Litigation*, 584 F.Supp.2d 546, 559 (E.D.N.Y. 2008) (motion to dismiss) and 810 F.Supp.2d 522, 525-26 (E.D.N.Y. 2011) (summary judgment motion).
- In re Vitamin C Antitrust Litigation*, 837 F.3d 175 (2d Cir. 2016).
- See 1966 Advisory Committee Notes at adoption of FRCP 44.1.
- United States v. Pink*, 315 U.S. 203 (1942).
- Slip Op. at 9-10.

Peter Sullivan

Foley Hoag, New York  
psullivan@foleyhoag.com

# The impact of *inter partes* review on patent rights and patent litigation in the United States

The United States patent system continues to be popular for companies around the world looking to protect their intellectual property. Earlier this year, the US Patent & Trademark Office (USPTO) issued US Patent Number ten million. The rate of patent issuance has steadily increased, proceeding at a rate of one million issued patents every three-to-four years. The top ten patent recipients, including companies like IBM, Samsung, LG, Facebook and Alphabet, each received patents numbering in the several thousands.

## Background: the need for patent reform

Patent infringement litigation also remains robust in the United States. Patent infringement is a strict liability offence. There is no requirement to prove that the infringer knew of the patent or was negligent in overlooking the patent. With so many patents out there, it is not difficult for an operating company to unwittingly infringe a patent. Many companies have found themselves surprised to receive a notice letter with a request to take a patent license to avoid alleged infringement. Adding to the heartache for some was the realisation that the patent claims technology that should not have been granted in the first place.

In recent decades, patent assertion has become more widespread. Chafing at this new cottage industry of patent assertion companies, the technology industry argued that there were numerous patents of 'dubious' quality being asserted improperly by non-producing entities who sought to extract unreasonable royalties. Congress picked up this theme in debating patent reform measures. What resulted was the Leahy-Smith America Invents Act, Pub. L. No. 112-29, 125 Stat. 284 (2011) (AIA).

The AIA arrived on the scene during that time of increased US patent litigation. The US had begun experiencing a sharp rise in the number of filed patent infringement

cases since 2008. The number of filed patent infringement suits rose in the US from 2573 in 2009 to 3596 in 2011. That number climbed to 6130 in 2013.

In enacting the AIA, Congress established *inter partes* review (IPR). IPR allows anyone except the patent owner to challenge the validity of a patent claim through an administrative proceeding within the PTO. For a defendant in a patent infringement action, this allowed for administrative review of the patent rather than litigating the claims in a district court. Prior to 2011, the only way a third party could challenge a patent in an administrative proceeding was through the patent re-examination procedure which, if instituted, would proceed in a manner similar to initial patent examination.

This new IPR process for patents was a fairly radical departure, providing patent challengers with a new and expanded weapon with which to challenge issued patents. For example, the AIA lowered the threshold to institute IPR in contrast to re-examination, allowing review if there was a reasonable likelihood that the petitioner would prevail in demonstrating the unpatentability of at least one of the challenged claims. Once instituted, the Board would determine validity on the basis of the preponderance of the evidence. By contrast, district courts weighed validity challenges under the higher 'clear and convincing evidence' standard.

IPR gave interested parties a faster, less expensive avenue to challenge a patent. Legal costs associated with IPRs typically run into the hundreds of thousands of dollars, versus a federal district court action that can typically total several million dollars through trial. IPR also provided time certainty, with a 12-month deadline from the date of institution in which the USPTO is required to issue a final written decision. District courts have also been relatively accommodating in granting stays of infringement litigation once an IPR is instituted.

Most of these provisions are more to the benefit of the challengers than the patent holders, but patent holders do obtain one advantage. Petitioners are estopped against using the same arguments in district court that had already been considered (or could reasonably have been considered) and rejected in the IPR.

### AIA achieves its objectives

The AIA has been quite successful from a patent-invalidating perspective. Overall institution rates have been high, from 87 per cent (on a small sample size) in 2013 to 62 per cent in 2018. Once instituted, patent holders face an uphill battle. Where IPRs have been instituted, all claims have been invalidated 65 per cent of the time, and some claims have been invalidated 16 per cent of the time. Less than 20 per cent of patents under review come out unscathed. Since the inception of IPRs, there have been 8,605 petitions filed, with over 4,400 petitions instituted. The Patent Trial and Appeal Board (PTAB) has invalidated all claims in 1,400 patents and at least some claims in another 349.

During the years in which IPRs have been available, the number of filed patent cases has decreased. Since hitting a high of 6,130 filed cases in 2013, the number of filed patent cases has been dropping, with 4,045 new cases filed in 2017 and about the same number expected for 2018 based on filings to-date. While there may be a number of factors involved in the declining litigation filing rates, some responsibility must be held by the availability and use of IPRs.

### Unintended consequences

The IPR system has given rise to more patent invalidations. Some commentators have observed the high invalidation rate from the Board with some dismay. The Board has had to fend off accusations that it has become a patent 'death squad.' There is a concern that IPR has made it easier to kill not only patents of poor quality, but also seemingly strong patents as well.

The life sciences industry, in particular, has been affected by the use of IPRs in challenging patents in patent litigation under the Hatch-Waxman Act. Patents directed to life science inventions represented between 11 per cent and 12 per cent of challenged claims from 2016 to 2018. The institution

rate for these claims was 61 per cent in 2016, 63 per cent in 2017, and 60 per cent in 2018. The commercial significance to a life science company of having a single patent challenged can be much more significant than that for a single patent in another type of technology, because a single patent can be the basis for a billion dollar drug program. Uncertainty in the strength of the patent portfolio will negatively affect the company's ability to raise capital for these programmes.

The availability of AIA challenges also gave rise to behaviour that would not have been considered a goal of the legislation. For example, financiers began to file petitions to invalidate patents on companies with the apparent aim of affecting that company's stock prices. One such hedge fund manager became notorious in patent circles for a short-selling scheme, whereby he would file and then publicise the filing of petitions in the hopes that the negative publicity would drive down the stock price, with mixed results.

Finally, following the theme of IPRs being perhaps too successful at invalidating patents, some petitioners have filed multiple petitions on the same claims in a patent, or on overlapping claims on the same patent. A third of the patents challenged had at least two petitions filed against them. Until recently, this practice had been allowed to take place unchecked. In one particularly egregious example, a company had to defend a total of 23 petitions filed against one of its patents, and ultimately lost all claims. The institution rate on a per-patent basis increases by about six or seven percentage points (70 per cent in 2018, for example) when counted this way. Putting aside the merits of any particular petition, having to defend multiple petitions will drain a patent owner's resources quickly.

### Court challenges

Because the law is relatively new, several open questions have required litigation, and some of those questions have gone all the way up to the US Supreme Court. The Supreme Court has now weighed in on several issues arising in IPRs:

In *Cuozzo Speed Technologies LLC v Lee*, the Court held that the proper claim construction standard under the statute is the standard used in patent examination, 'broadest reasonable interpretation,' rather than the district court standard. This standard is broader than the standard used in district

court litigation, which means that claims may be construed more broadly by the PTAB than the district court and consequently it would be that much easier to invalidate the claim in an IPR.

In *Oil States Energy Services LLC v Greene's Energy Group LLC*, the Court held that there was no right to have validity claims heard by an Article III court rather than an administrative body such as the PTAB. This means that the IPR regime is not going anywhere in the near future.

In *SAS Institute v Matal*, the Supreme Court held that all grounds that are raised in a petition for IPR must be addressed in the final written decision or in the decision not to institute. This ended the practice of partial institution that the Board had been using to streamline its review process.

The United States Court of Appeals for Federal Circuit, which reviews appeals of any decisions coming from the PTAB, has also provided guidance on the AIA. In a recent example, the full *en banc* court in *Aqua Products, Inc. v Matal* held that the Board's practice toward claim amendments during IPR was too restrictive, with the effect that the burden of proof appeared to be placed on the patent owner for seeking to amend claims.

Some parties have attempted to use recent precedent to skirt IPRs altogether. In several cases involving state universities, the Board determined that the state enjoyed sovereign immunity under the 11th Amendment which precluded the Board from reviewing the patent in an IPR. A creative patent owner sought to exploit and expand on the holding by assigning patents to a Native American Nation (tribe) and thus take advantage of sovereign immunity granted to foreign sovereigns. Unfortunately for the patent owner, the Board refused to terminate the proceedings on the basis of tribal sovereign immunity.

### Attempts to address shortcomings

There have been recent movements to address a number of the perceived shortcomings of IPRs. Several of the movements have come from within the USPTO.

The Board has provided guidance on amendment practice within IPRs to ensure that the burden of proving a patent invalid stays

with the petitioner. It should now be easier for patent owners to propose amendments to claims as a way to overcome challenges.

The Board has provided guidance to assist current parties to IPRs regarding the implications of SAS decision.

The Board has made precedential a recent decision that provides a non-exhaustive list of factors to consider for follow-on petitions on the same patent. The expectation is that Board panels, armed with this guidance, will scrutinise follow-on petitions more closely, and that the practice will wane as a result.

The USPTO is proposing a change in the claim construction standard from broadest reasonable interpretation to the standard used in district court proceedings. A broader interpretation of a claim term results in more prior art potentially available to apply to the reference. This tends to make it easier to invalidate a claim in IPR than would be the case in a district court proceeding, without also accounting for the lower burden of proof in IPRs.

Other proposals have been directed to Congress. In one notable instance, the pharmaceutical industry has been lobbying Congress to amend the AIA to prevent a generic manufacturer from using the provisions of the Hatch-Waxman Act and, at the same time, file a petition for IPR. In response, Senator Hatch has proposed the Hatch Waxman Integrity Act of 2018, which would require a generic manufacturer to choose either IPR or Hatch-Waxman litigation.

Finally, there are some who still wish to abolish AIA altogether. Congressman Thomas Massie (R-KY) introduced a bill in the House entitled, Restoring America's Leadership in Innovation Act of 2018, which would, among other things, abolish the PTAB.

### Conclusion

After five years, IPRs have proven to be effective in invalidating patents that would otherwise have consumed significant litigation resources. IPRs are most likely here to stay, but the process will continue to be reformed to address perceived inequities for patent owners. We should expect that IPRs will continue to shape patent litigation in the US for years to come.

## LATIN AMERICA

# Collective actions: trends and currents in Latin America

Over the last decades, collective actions have seen a significant development in the legal practice of different countries in South America.

Some countries have enacted specific laws to regulate the substantive and procedural aspects of collective actions, whereas in other countries this legal institute has not been formally regulated, despite being in practice.

This article reviews the current situation of collective actions in Argentina, Brazil, Colombia, Ecuador, Mexico, Peru and Venezuela and the latest trends on the subject. This article also includes Spain, as it has a similar jurisdiction.

## ARGENTINA

### Rodrigo García

Marval, O'Farrell & Mairal, Buenos Aires  
rfg@marval.com

In Argentina, there is currently no specific law that regulates collective actions.

However, these actions have become very common in practice, since their recognition by the National Supreme Court in the leading cases 'Halabi' (2009)<sup>1</sup> and 'Padec' (2013),<sup>2</sup> as a mechanism to protect: 1) collective rights related to collective interests; and 2) collective rights concerning individual, homogeneous interests.

The National Constitution recognises legal standing to sue in protection of collective rights to the affected individual, the ombudsman and the consumer associations properly registered.

For the admission of actions concerning individual homogeneous interests, the National Supreme Court has outlined the following requirements:

- the existence of a common factual cause affecting an important number of individual rights;
- that the claimants seek a common remedy;
- the economic losses should not justify individual claims; and
- the Court must recognise the potential members of the class.

Due to the lack of a legal framework, the Supreme Court has also intended to fill the legal gap issuing: 1) Decree 32/2014,<sup>3</sup> to create a Public Registry of Collective Proceedings to give publicity and to avoid contradictory decisions in similar cases;

and 2) Decree 12/2016,<sup>4</sup> to establish formal requirements to manage collective proceedings.

Currently, there are more than 1,000 collective actions registered at national level, related to insurance, financial services, credit cards, oil and gas, telecoms, etc.

Despite the fact that lots of bills have been introduced before the National Congress, none of them has been sanctioned up to date. Nevertheless, 'Justice 2020', a programme from the Ministry of Justice and Human Rights, has recently presented a new preliminary draft.<sup>5</sup>

At this point of practice, it is essential for judges, legal practitioners and for the entire community in Argentina to have a legal framework that regulates collective actions on an effective basis.

#### Notes

- 1 <http://sjconsulta.csjn.gov.ar/sjconsulta/documentos/verDocumentoByIdLinksJSP.html?idDocumento=6625571&cache=1532440778018>
- 2 <https://sjconsulta.csjn.gov.ar/sjconsulta/documentos/verDocumentoByIdLinksJSP.html?idDocumento=7034831&cache=1532441001467>
- 3 <http://servicios.infoleg.gob.ar/infolegInternet/anexos/235000-239999/237649/norma.htm>
- 4 <http://servicios.infoleg.gob.ar/infolegInternet/anexos/260000-264999/260206/norma.htm>
- 5 <http://www.justicia2020.gob.ar/wp-content/uploads/2018/05/Anteproyecto-de-Ley-Procesos-Colectivos-FINAL.pdf>

The collective action in the Brazilian legal system seeks to defend diffuse interests (indivisible rights held by uncertain persons connected by facts), collective interests (the interests of a group, class or category of persons interconnected or connected with the adverse party through a legal relationship) and homogeneous individual interests (with a common triggering event, affecting persons on an individual basis and in the same manner).

In particular, the public civil action (Law 7,347/1985) primarily seeks liability for moral and property damage caused to the environment, consumer, economic order, assets and rights of artistic, aesthetic, historical, tourist, urban and landscape value. More recently, through the 2014 legislative amendment, important rights enshrined in the Brazilian Federal Constitution of 1988, namely the right to honour and dignity of racial, ethnic or religious groups and to public and social assets, were inserted among the rights protected by the public civil action.

Despite the fact that this type of action has become more relevant, it still faces obstacles. Recent research carried out by the National Council of Justice and by the Brazilian Society of Public Law<sup>1</sup> found out that, firstly, the main reasons for inefficient actions for magistrates are a lack of speed and the complexity of the cases and, secondly, the principal solutions to increase the efficiency of actions would be the creation of specialised lower courts and the systematisation of procedures.

In addition, some controversies must be settled, such as those relating to the effects of the decision rendered in a collective action, which are limited by the law to the territorial jurisdiction of the issuing court, but for which, on several occasions the prevailing stand was that the decision is valid throughout the Brazilian territory. This would prevent multiple repeated lawsuits and possible contradictions among respective decisions.

#### Note

- 1 [www.cnj.jus.br/pesquisas-judiciarias/justica-pesquisa/publicacoes](http://www.cnj.jus.br/pesquisas-judiciarias/justica-pesquisa/publicacoes).

## BRAZIL

### Théra van Swaay De Marchi

Pinheiro Neto,  
São Paulo  
tdemarchi@pn.com.br

### Felipe Evaristo dos Santos Galea

Barbosa Mussnich  
Aragão, São Paulo  
fes@bmalaw.com.br

For some time, certain kinds of collective actions have been set out in various laws, such as in consumer protection matters. However, in 2010, through a reform of Article 17 of the Mexican Constitution,<sup>2</sup> collective actions were expressly recognised at a constitutional level, forcing the Federal Congress to issue legislation, through which an effective judicial procedure was designed to ensure the protection of diffuse and collective rights and interests. This implied a radical change to the eminently individualistic system that existed previously in the Mexican legal order.

As an example of Mexican jurisprudence on the subject the First Chamber of Mexico's Supreme Court, deciding on a case derived from a collective action,<sup>3</sup> recently forced the urban public transport service in Mazatlán, Sinaloa, to install the necessary equipment to provide air conditioning, setting an important precedent that the offender should repair the general damage and not just cover individuals' damages.

However, collective actions have not yet pervaded the Mexican legal system, given that their use has been limited. To give an example, according to official data, since the constitutional reform of 2010 and

until 2017, only 14 collective actions had been exercised by the Federal Consumer Protection Agency (PROFECO),<sup>4</sup> a figure that does not correspond to the reality that exists in the country in relation to the violation of consumer rights.

#### Notes

- References: ARELLANO TREJO, Efrén and CÁRDENAS SÁNCHEZ, J. Guadalupe, *Acciones colectivas en México: la construcción del marco jurídico* (Centro de Estudios Sociales y de Opinión Pública, 2011) 1-14; CRUZ ESPINOSA, Armando, 'Las acciones colectivas en México' (CASTILLO GONZÁLEZ, Leonel and MURILLO MORALES [Coord.]), Jaime, *Acciones colectivas: Reflexiones desde la judicatura, Instituto de la Judicatura Federal* (Mexico, 2013) 127-155; KRASOVSKY, Luis Miguel, *¿Por qué no están progresando las acciones colectivas?*, (El Mundo del Abogado, Febrero 2017).
- 'DECREE by which a third paragraph is added and the order of the subsequent paragraphs of Article 17 of the Political Constitution of the United Mexican States is modified', published in the Federal Official Gazette on 29 July 2010.
- First Chamber of the Mexican Supreme Court of Justice, *Amparo Directo 11/2016*, Plaintiff: Alianza de Transportadores y Camioneros de Servicios Urbanos y Suburbanos de Mazatlán, Sinaloa, decided on 31 May 2017, public version of the ruling available at [www2.scjn.gob.mx/ConsultaTematica/PaginasPub/DetallePub.aspx?AsuntoID=194948](http://www2.scjn.gob.mx/ConsultaTematica/PaginasPub/DetallePub.aspx?AsuntoID=194948).
- PROFECO, public information available at [http://acolectivas.profeco.gob.mx/documentos/REVISTA\\_PROFE\\_ACC.pdf](http://acolectivas.profeco.gob.mx/documentos/REVISTA_PROFE_ACC.pdf).

## MEXICO

### Juan José Iturbe López

Malpica, Iturbe, Buj & Paredes, Mexico City  
jiturbe@mibp.com.mx

### Alejandro Agredano Zermeño

Malpica, Iturbe, Buj & Paredes Mexico City<sup>1</sup>  
aagredano@mibp.com.mx

## VENEZUELA

## Carlos Domínguez

Lega, Caracas  
cdominguez@lega.law

## José Gregorio Torrealba

Lega, Caracas  
jtorrealba@lega.law

In Venezuela, class actions shall be understood as collective actions initiated on behalf of a group of persons that have a common interest in a given process. Article 26 of the Constitution stipulates that: 'Each individual is entitled to access the institutions of justice administration in order to enforce their rights and interests, including those that are collective or common...' The Venezuelan Constitution includes the possibility of defending collective and common interests.

Common interests are those that affect the community; while collective interests are those that only affect certain groups within such communities.

In the Venezuelan system, the concept that most resembles class actions would be the actions for the protection of collective interests.

It covers a specific (yet unquantified) and (individually) identifiable sector of the population, which is or may be legally connected.

Actions derived from collective interests or rights are always sentencing actions that seek to cure the situation; they are not declarative or constitutive. The Constitution also stipulates the payment of indemnification as a component of the claim based on these rights and interests.

The Actions may be undertaken by the Ombudsman Office, and by any member of the group or sector related to that specific community, who shall act in favour of the community. The number of claimants is not relevant.

Collective rights entail the existence of collective persons (the nation, unions, etc) or minorities (ethnic, religious groups, etc) that, despite having a specific structure, may not be companies, or even a group of organised individuals seeking to preserve the common welfare of those who are in the same situation.

Also, regarding indemnifications derived from collective interests, these can only be demanded for companies by their members, or by individuals, by patenting their subjective rights, which prevents other persons from enjoying them. However, if the judgment does not establish a violation but the restoration of a common situation that has been damaged, other members of the community can benefit from this judicial declaration, if they so express it.

The Decision has *erga omnes* effects: these effects are extended to the decision issued, since it harms or benefits defined sectors of the community and produces *res judicata*.

## ECUADOR

## José David Ortiz

Pérez Bustamante & Ponce, Quito  
dortiz@pbplaw.com

The Constitution of Ecuador recognises rights of several types, among them individual, collective, and diffuse rights as well as the rights of Nature. The Constitution also states that rights may be exercised, promoted and demanded individually or collectively. Collective rights are specific rights which are enjoyed by certain groups - such as the rights of the indigenous people and nationalities - in respect of which it is possible to determine who can claim and who is affected if those rights are violated. Diffuse rights are those that cannot be appropriated by one single individual or group and whose violation affects all of them, but it is not possible to determine specifically who is affected.

The 2008 Constitution of Ecuador is innovative in recognising Nature as a subject of rights and allowing popular action instituted by private citizens for the purposes of bringing legal actions to redress violations of these rights. Likewise, the 1998 Constitution allowed popular action instituted by private citizens for claiming against violations of the diffuse right to live in a healthy environment, now recognised by

the Organic Environmental Code as well as by the current Constitution. Furthermore, the Constitution permits the filing of constitutional actions in the event of threat or violation of collective rights. Besides, the Organic Consumer Defence Law establishes the possibility of bringing collective actions to claim the protection of consumers' collective interests.

In this sense, it is important to clarify that collective actions precisely protect collective rights when a legal relation or link among the members of the group exists. Collective actions in Ecuador do not protect *homogenous individual rights*.<sup>1</sup> Despite the fact that collective actions have been recognised in Ecuador, major challenges still exist, such as the issuance of norms to adequately regulate the representation of collective groups, cases regarding an interrelation or *lis alibi pendens* among claims filed by several groups and the effects of *res judicata* (claim preclusion) that might result from judgments.

## Note

- 1 With the exception of collective conflicts to claim labour-related rights.

Collective actions are vested with a constitutional rank in Colombia (Article 88 of the Constitution). Law 472 of 1998 created two types.

The first type, called People's Action (*Acción Popular*), similar to injunctive relief classes in the United States, is intended for the safeguard of collective rights and interests. Law 472 provides a non-exhaustive list of protected collective rights and interests, such as a healthy environment and public health, among others.

People's actions are not meant for recovering damages. However, Article 39 of Law 472 entitled the plaintiffs with a pecuniary incentive, which instigated the abuse of people's actions. Said incentive was repealed in 2010 and, consequently, the filing of people's actions in Colombia decreased by almost 80 per cent.

The second type, called Group Action (*Acción de Grupo*), is very similar to the damages class action in US law. Class or group actions are meant for the compensation of monetary and

non-monetary damages suffered by a plural number of persons; the law requires that the class is comprised of at least 20 members. Nevertheless, case law has explained that one individual can file the class complaint and represent a whole class, as long as the group is clearly identifiable and the potential members share uniform conditions with regards to the causation of the damages sought.

With respect to *res judicata* in class actions, Law 472 establishes a mixed system in which the persons with standing to sue, and who would belong to the class, can either opt-in or opt-out within certain opportunities, in order to become parties to the proceedings, or to avoid being covered by a settlement or a final judgment within the class action. Except for the persons who opt-out in time, the judgment or settlement will be final for all identified and potential members of the class. Thus, if new members appear, the same amount of any compensation awarded will be re-allocated among the class, and no new related actions shall be filed.

## COLOMBIA

### Christian Perez Rueda

Lloreda Camacho & Co, Bogotá

cperez@lloedacamacho.com

The protection of diffuse interests has been expressly ruled in Peruvian laws.

Diffuse interests have been described by the Civil Procedure Code as: 'those owned by a spread group of people, with respect to goods with no patrimonial value, such as environment, cultural or historical heritage or consumer rights.'

The Constitutional Court stated in STC 1757-2007-PA / TC: '15.... diffuse rights have a special characteristic, which gives them a particularity: no one in particular is an exclusive owner and at the same time, all members of a certain group or category are its holders.' In said claim, referred to the constitutional protection of a public park, the Court added: 'its protection implies defending property and constitutional diffuse interests because each and every person has a proper title'.

The following is a correct and simple distinction of these categories:

- individual interest: due to one procedural subject;
- collective interest: due to a specific group of procedural subjects;
- diffuse interest: due to a spread group of people.

Thus, when the law specifically rules the protection of diffuse interest, it is not including the protection of the collective interest, since collective interests have a specific set of persons as owners. Peruvian law and court orders have established that diffuse interests have non-patrimonial value, while collective interest may have this. Obviously, laws that specifically rule collective interest (of consumers or children) do admit collectivities that can act in defence of a group interest, whether or to the claim's object patrimonially estimable.

Likewise, authorised claimants are: 1) public institutions; 2) private institutions; and 3) any person (class action).

It should be added that Peruvian law has developed a theme of 'access to jurisdiction', enabling different persons (natural or legal) to act on their own, claiming protection of rights that are not theirs. Peruvian law also enables public officers such as prosecutors or the ombudsman, as well as public institutions as the National Institute for the Defense of Free Competition and the Protection of Intellectual Property, a phenomenon recognised as 'the publicisation of subjective rights'.

## PERU

### Lourdes Flores Nano

Lourdes Flores Nano, Lima

lflores@lfnabogados.com.pe

## SPAIN

**Félix Montero**

Pérez-Llorca, Madrid  
fmontero@perezllorca.com

**Raquel López**

Pérez-Llorca, Madrid  
rlopez@perezllorca.com

Class actions are not expressly defined as such under Spanish law as this occurs in other legal systems. However, the Spanish Civil Procedural Act (SCPA)<sup>1</sup> provides that collective actions may be brought in the following scenarios:

Actions for cases in which group members are identified or easily identifiable (Article 11.2 SCPA).

Actions for the protection of ‘diffuse interests’ for cases in which the affected group is undetermined or difficult to determine (Article 11.3 SCPA).

In practice, collective actions are common in the field of 1) unfair terms included in banking mortgage agreements entered into by consumers; 2) product liability cases; 3) damages derived from unfair competition acts; and 4) insurance litigation. In this regard, the most recent landmark case was the Spanish Supreme Court Decision dated 9 May 2013 [RJ 2013, 3088], whereby the ruling was in favour of the claimant – a consumers’ association<sup>2</sup> – which sustained that floor clauses included in loan agreements secured with mortgage should be declared void, due to lack of transparency in that case.

Legal standing to bring collective actions is limited to: 1) consumers’ and users’ associations; 2) legally constituted entities, and

3) groups of affected consumers. Therefore, any other entity falling out of those categories lacks standing to bring a collective action. For instance, the Madrid Court of Appeals’ Decision dated 17 January 2013 [AC 2013, 866] dismissed a collective action arising from the Madoff investment scandal on the basis that the claimant lacked standing in accordance with Article 11 of the SCPA, as the requirements are interpreted very strictly in this regard.

As for the future of collective actions, at the EU level there is a proposal dated 19 April 2018 –prompted in part by the ‘VW Dieselgate’ case – which has been named as ‘New Deal for Consumers’<sup>3</sup> and under which qualified entities would be entitled to seek redress on behalf of a group of consumers that have been harmed by an illegal commercial practice. This is similar to the current Spanish law regime on collective actions. If the proposal is finally approved, all EU Member States would be required to incorporate the laws into their domestic legal systems.

**Notes**

- 1 Ley 1/2000, de 7 de enero, de Enjuiciamiento Civil.
- 2 Asociación de Usuarios de los Servicios Bancarios (Ausbanc Consumo).
- 3 More information is available at: [http://europa.eu/rapid/press-release\\_IP-18-3041\\_en.htm](http://europa.eu/rapid/press-release_IP-18-3041_en.htm).

## EUROPE

# Taking it personally: individual accountability in the UK financial services sector

**Jamie Symington,  
Partner**

Brown Rudnick,  
London

jsymington@  
brownrudnick.com

**T**he Financial Conduct Authority (FCA) is the conduct regulator for nearly 60,000 financial services firms (eg, banks and hedge funds) and financial markets in the UK. It is a regulator with real ‘bite’, given the sanctions it can impose on those it regulates and indeed those who operate unregulated in a regulated sector. For example the FCA can impose fines and can make findings which mean that a person would no longer be regarded as a ‘fit and proper’ person who can operate in the regulated sector.

A client may therefore find that their conduct results in legal action by the FCA which ultimately impinges on their ability to work in the regulated sector in the future. It could also result in a civil claim by the ‘victim’ of any misconduct for compensation and in a criminal investigation which could lead to a loss of liberty. Such a client would need to have a legal team expert in all three disciplines to ensure a coordinated and thoughtful response.

In July of this year, the FCA published long-awaited rules that extend the Senior Managers and Certification Regime (SMCR) to all the firms it authorises. These rules will be in force by the end of 2019. The SMCR has already been in place since March 2016 for banks and major investment firms. This means that by the end of 2019 there will be in place a comprehensive personal accountability regime for all regulated financial services firms in the UK and those working within it. What, therefore, are the implications for firms and individuals in the UK regulated financial services sector?

The FCA says the aim of the SMCR, is to reduce harm to consumers and strengthen market integrity by making individuals more accountable for their firm’s and their own conduct and competence. As part of this,

the SMCR aims to encourage a culture at all levels of staff to take personal responsibility for their actions and to make sure firms and staff clearly understand and can demonstrate where responsibility lies.

The ‘culture’ in the industry is something that has been troubling UK regulators for some time. Ever since Adair (Lord) Turner’s time as Chairman of the UK Financial Services Authority (the predecessor of the FCA), UK regulators have been vocal on this subject. In the aftermath of the financial crisis, which was soon followed by the exposure of widespread misconduct in the sector as the Libor and Forex benchmark rigging scandals surfaced, commentators noted that society’s trust in the sector was at a low ebb. Consumer groups, regulators, parliamentarians and media commentators alike concurred that cultural issues were a root cause of the crises that had blighted the industry in recent years.

A Parliamentary Commission on Banking Standards, established in the wake of these scandals carried out a thorough review of the sector and made a number of recommendations in 2013. Its conclusions were that it was often not possible to hold senior managers to account in the event of failures in a firm. This was because it was too often not possible to see how responsibilities were attributed to individuals in any meaningful way. The response was proposed legislative change to introduce a new tier of regulation imposing more meaningful individual accountability. The Financial Services (Banking Reform) Act 2013 put this legal framework in place. The SMCR implements the regime through rules that make significant changes to individuals’ personal liability and impose requirements regarding how firms are run.

## Senior managers

At the top level, the SMCR imposes accountability on the most senior managers in firms. This includes, as you would expect, board members, top level executives, heads of key business areas and other roles prescribed under the regime. Senior managers must be assessed as being fit and proper by the firm, and also be approved individually by the regulator. There must also be in place a clear statement of responsibilities for each senior manager. The firm must put in place and keep updated a ‘responsibilities map’, detailing how responsibilities within the firm are allocated to senior managers.

Importantly, the regime imposes a statutory ‘duty of responsibility’ on senior managers. This means that if a firm is in breach of the regulatory requirements and standards, the senior manager responsible for the relevant area can be held to account if they did not take ‘reasonable steps’ to prevent or stop the breach. This may mean the senior manager is personally fined and/or faces a suspension or ban from the industry.

This is not a strict liability regime; the burden of proof remains with the regulator to show that the senior manager did not take the steps that a person in their position could reasonably be expected to take. Nevertheless, in the event of an investigation or enforcement action by the regulator, the individual will need to be able to show through evidence what steps were taken and how those amount to reasonable discharge of responsibilities.

What amounts to reasonable steps will always depend on the facts: the FCA rules and guidance do not provide a comprehensive ‘how to’ guide for senior managers. However, it will be important in every such case, both for the firm and for the individual, to be able to demonstrate what the governance arrangements were, what policies and processes were in place and how those were executed in practice. Senior managers can of course, delegate, but in that event they will need to show that they have done so responsibly, for example, with evidence of how reporting and escalation operated and of how management information was used.

## Certification regime

At the next level down of the SMCR is the Certification Regime, which applies to people who are not managers, but whose

responsibilities mean that they are in a position to cause significant harm to the firm or its customers. This might include, for example, persons with significant management functions and persons who deal regularly with clients such as advisers or brokers. It may also include proprietary traders, persons who operate trading algorithm systems, and other material risk takers. Such persons are not individually approved by the regulator, but the firms will need to certify annually to the regulator that they are fit and proper to perform the function.

## Conduct rules

At the base level of SMCR are the Conduct Rules. These are a comprehensive set of rules applicable to all non-ancillary employees (that is, excluding catering, security etc) of regulated firms. They are widely-drawn provisions such as: ‘You must act with integrity’ or ‘You must act with due skill care and diligence’. In addition, further specific Conduct Rules apply to senior managers. These include, for example: ‘You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.’

## Enforcement of SMCR

By introducing these measures, the UK regulators are in step with other regulators internationally. The United States Security and Exchanges Commission listed (in a report in November 2017) individual accountability as a core principle guiding its enforcement decision-making. The Monetary Authority of Singapore consulted in April 2018 on a proposed regime for individual accountability. Australia introduced the Banking Executive Accountability Regime in July 2018. The Hong Kong Security and Futures Commission (SFC) introduced the Manager-in-Charge regime in October 2018.

However, a new legal framework for individual accountability will only make a difference if regulators are willing to enforce it. The UK regulators have far-reaching powers to investigate firms and individuals for suspected misconduct and powers to impose unlimited fines on individuals and firms, as well as powers to ban or restrict their activities. With new leadership of the FCA’s Enforcement Division under Mark Steward who arrived from the Hong Kong SFC in 2015, all the signs are there that the FCA will be using its powers under the new framework to the full. Steward’s arrival

coincided with the publication of a report into historical action by the FCA following the failure of HBOS.

This report was critical of the regulator's decisions on whether or not individuals should be put under investigation. Decisions to open FCA investigations are now taken strictly on the statutory test of whether there are 'circumstances suggesting' misconduct has occurred. As a consequence, the number of investigations opened has grown over the last two years, with nearly three times as many investigations opened during FY2017/2018 than had been opened in the financial year prior to Steward's arrival. What is also true is that increasingly the focus of

FCA investigations is on the role of senior management and accountable individuals.

Not all of these investigations will result in enforcement action, and the FCA says that it expects proportionally fewer of them will do, given that they are opening investigations on a lower evidential threshold. However, individuals who are the subject of an investigation may still be exposed to life-altering impact, whether emotionally or in terms of career impact. The FCA is committed to using its powers proportionately and fairly. Nevertheless, there can be little doubt that, at least in the UK, the risk of individual exposure is greater now than at any time in the past.

---

## New ways to tackle fraud in the UK

**Kate McMahon**

Edmonds Marshall  
McMahon, London

katemcmahon@  
emmlegal.com

**F**raud is a worldwide problem requiring ever faster and better-informed legal solutions. For victims affected by fraud, the viable recovery options in the United Kingdom were previously commonly limited to reporting the matter to the police or instructing a good civil solicitor. However, we are now seeing a great rise in cases in the UK using an alternative tool: private prosecution. This is available in many common law countries and some civil law countries.

### What is a private prosecution?

A 'private prosecution' is a criminal prosecution pursued by a private person, corporate or body, and not by a statutory prosecuting authority. It is enabled by section 6(1) of the Prosecution of Offences Act 1985. The right to bring a private prosecution is considered to be of constitutional importance in the UK.

In the majority of jurisdictions around the world (particularly non-common law), the criminal justice system is seen to be a function of the State, which investigates and prosecutes alleged offenders on behalf of the public and for the benefit of the public. This is not the case in the UK, where it is possible to bring

public and private criminal proceedings (although not simultaneously if relating to the same charges).

### Why are the police not investigating all cases?

In the current climate of austerity, budgetary constraints and crimes of increasing complexity, the use of private prosecutions is undoubtedly on the increase. In 2012, this increase was noted by the Lord Chief Justice of England and Wales who commented, 'there is an increase in private prosecutions at a time of retrenchment of state activity in many areas where the state had previously provided sufficient funds to enable state bodies to conduct such prosecutions.' Economic crime has been particularly under-prioritised in the UK, particularly since terrorism incidents required greater resources. As of September 2017, there were 121,929 police officers in England and Wales, the lowest number in at least 20 years. Whilst spending on other types of policing has dropped since 2015, it has increased in counter-terrorism where an £3.4bn was pledged to be spent between 2015-2020.

### Do I have to be a victim to bring a private prosecution?

There is no requirement that a private prosecutor is the victim of the crime, or connected to the crime that they wish to prosecute. Any person or entity having 'legal personality', including companies and charities, has the ability to pursue a private prosecution.

### The Government Prosecutor

The Government Prosecutor in the UK (the CPS) will decide whether to prosecute public cases by following and applying the Code for Crown Prosecutors. The principle test applied, known as the 'Full Code Test', is whether the evidence discloses a reasonable prospect of conviction and, if so, whether the prosecution is in the public interest. Only if both these tests are met should a case be prosecuted. The 'reasonable prospect of conviction' test is not the same as 'beyond reasonable doubt'; it is a much lower evidential threshold. Whilst lawyers are loath to use percentage terms for such tests, it has been referred to as the '51 per cent chance test' or the 'greater than even chance test'.

The Full Code Test does not strictly apply to private prosecutions. However, there are good reasons why it is sensible to ensure that this test is capable of being met as, otherwise, the State Prosecutor can take over and discontinue a private criminal case (and costs may follow). It is also possible for the State Prosecutor to take over and continue the prosecution (typically this may occur if the subject matter is highly political) or allow the private prosecutor to continue.

### What about asset recovery?

A private prosecutor is also entitled to pursue confiscation proceedings against a convicted defendant under the draconian Proceeds of Crime Act 2002, post-conviction. Confiscation proceedings are secondary proceedings after a trial or sentence for the predicate offence. There is an analysis undertaken by the court of the: 1. available assets of the defendant; and 2. the value attributable to the criminal conduct. If the defendant is able to demonstrate that this is not feasible, the court may extend it by six months, with discretion for a further six-month extension in exceptional circumstances.

Interest of eight per cent will accrue on any unpaid confiscation amount. In the event

that the confiscation order is not satisfied, enforcement proceedings can commence in the Magistrates Court, with the Magistrates Court empowered to appoint an enforcement receiver. If the confiscation order is not satisfied, a default sentence will be imposed, which will run consecutively to the term of imprisonment imposed for the substantive offence(s). The default sentence pertaining to a confiscation amount of more than £1 million is 14 years imprisonment.<sup>1</sup> There is no alternative to paying the order and it will remain in force despite a default term of imprisonment being served.

Further, the court can also undertake a detailed analysis of how a defendant has benefitted from their criminal behaviour and whether they have a 'criminal lifestyle' (ie, to look beyond the discrete criminal benefit relative to the offence which is being prosecuted). In certain circumstances, the court can make assumptions that money/property held by a defendant has been obtained from criminal conduct, unless the contrary is proved.

The courts can also order compensation be paid to a victim from the confiscated proceeds of crime which enables the payment of compensation to be enforceable.

### Interesting case examples

There have been some interesting private criminal confiscations in recent years and a corporate and individual fraud are discussed below.

In 2014, Virgin Media Ltd utilised confiscation powers to obtain a confiscation order against individuals illegally selling set top boxes which allowed for free viewing of premium channels which viewers typically had to pay to watch via a subscription. It was estimated that Virgin's lost revenue as a result was £380m. The main defendant's (Mr Zinga's), benefit from the criminal conduct was assessed at £11.8m; the available amount was assessed at £8,771,300. It had to be paid within six months with a consecutive sentence of ten years in default of payment.

In 2017, a confiscation and compensation order was obtained by Mr Murli for £38,855,647 against serial fraudster Ketan Somaia. He was charged with nine counts of obtaining a money transfer by deception totalling \$19,690,000 (just over £12.25m), after Mr Somaia had persuaded Mr Mirchandani to make short-term loan payments to him with the assurance of high

rates of interest and investments in business opportunities over the period between June 1999 and August 2000. Mr Somia is also serving an eight-year prison term as a result of a private prosecution.

What seems certain going forwards is that there will be many more cases of this type in

the UK and, as an option for litigators, private prosecution should always be kept in mind.

**Note**

- 1 Section 35(2A) POCA, amended by section 10 Serious Crime Act 2015.

---

# Contractual freedom v contractual certainty: the UK approach to contractual No Oral Modification clauses

**Sara Chisholm-Batten**

Michelmores, London  
Sara.chisholm-batten@  
michelmores.com

**Naomi Hall**

Michelmores, London  
naomi.hall@  
michelmores.com

In a welcome judgment for contractual certainty, the Supreme Court of England and Wales has determined that clauses which prohibit modification of a contract orally ('No Oral Modification' clauses or NOMs) do just that: they prevent parties from amending a contract orally.

To the lay observer, this may not seem revolutionary: contracts, after all, are designed to be adhered to. It may be a surprise to some, however, to learn that prior to the Supreme Court decision in *Rock Advertising Limited v MWB Business Exchange Centres Limited* (2018) UKSC 24, which is examined in this article, there was a body of opinion which considered that NOM clauses may be ineffective. We also consider whether this new judgment means that the position in England and Wales is more (or less) aligned with other jurisdictions around the world.

On handing down the leading judgment in *Rock Advertising*, Lord Sumption remarked:

'Modern litigation rarely raises truly fundamental issues in the law of contract. This appeal is exceptional. It raises two of them. The first is whether a contractual term prescribing that an agreement may not be amended save in writing signed on behalf of the parties (commonly called a 'No Oral Modification' clause) is legally effective. The second is whether an agreement whose sole effect is to vary a contract to pay money by substituting

an obligation to pay less money or the same money later, is supported by consideration'.

This article focuses on the former of these fundamental issues as the court thought it unnecessary (and perhaps undesirable) to scrutinise the latter in further detail in this case. The question of what constitutes sufficient consideration was deemed to be 'ripe for re-examination' and may therefore be the focus of another Supreme Court decision in the not-too-distant future.

## Case facts

The case facts of *Rock Advertising* are relatively simple: MWB Business Exchange is a provider of serviced office space in London. Such office space was provided by MWB to Rock Advertising Ltd under a 12-month fixed-term licence (the 'Licence'). The NOM clause in the Licence provided that: 'All variations to this Licence must be agreed, set out in writing and signed on behalf of both parties before they take effect.'

Part-way through the Licence term, Rock Advertising had accumulated substantial arrears and became unable to continue to pay the agreed rates. The director of Rock Advertising proposed a revised payment schedule and, during a telephone call with a credit controller from MWB, the parties agreed to vary the Licence terms in

accordance with the revised schedule. Judge Moloney QC, sitting in the Central London County Court, considered that an oral agreement had indeed been made, though its effectiveness was a separate question.

Notwithstanding the purported agreement between the MWB credit controller and director of Rock Advertising, the existence of the variation was denied by MWB which terminated the Licence, locked Rock Advertising out of the premises and sued them for the arrears. Rock Advertising counterclaimed damages for wrongful exclusion from the premises.

### Court of Appeal

Considering whether the oral variation was effective in law and overturning the first instance decision of Judge Moloney QC, Kitchin LJ in the Court of Appeal, held that the NOM clause did not preclude any variation of the Licence. He reflected that the most powerful consideration was party autonomy: the principle of freedom of contract entitling parties to agree whatever terms they chose, subject to certain limits imposed by public policy.<sup>1</sup>

The fundamental question for the Supreme Court, therefore, was whether this view was correct. Was it really right that a prescriptive provision as to the form of contractual amendments, which had been agreed by the contracting parties, could effectively be ignored in the interest of purportedly upholding contractual freedom?

The Supreme Court thought not.

### Supreme Court decision: case law

In order to explore the rationale behind the Supreme Court's decision, it is first necessary, as Lord Sumption did in his judgment, to take a fleeting look through domestic and international legal principles of the past 100 years.

Fundamentally, under English common law, there are no administrative formalities that must be followed in order for a simple contract to be legally binding. Save for limited exceptions where statute provides otherwise (such as section 2 of the Law of Property (Miscellaneous Provisions) Act 1989, which requires, inter alia, contracts for the sale or other disposition of an interest in land to be in writing), oral contracts are binding under English law.

Such flexibility and informality are

frequently seen as real advantages to parties contracting under English law, allowing contracts to be made quickly and cheaply. However, the ability to make oral contracts, without any other formality, is a reason why NOM clauses, which prevent oral amendment, have been considered an erosion of party autonomy.

### US and other jurisdictions

Until the introduction of Part 2 of the United States Uniform Commercial Code, which includes a provision giving effect to NOM clauses,<sup>2</sup> there was long-standing endorsement of the precedent set by Cardozo J in the New York Court of Appeal case *Beatty v Guggenheim Exploration Co.*<sup>3</sup> In his judgment he stated:

'Those who make a contract, may unmake it. The clause which forbids a change, may be changed like any other. The prohibition of oral waiver, may itself be waived. 'Every such agreement is ended by the new one which contradicts it' [Westchester F Ins Co v Earle 33 Mich 143, 153]. What is excluded by one act, is restored by another. You may put it out by the door; it is back through the window. Whenever two men contract, no limitation self-imposed can destroy their power to contract again...'

The ability to contract orally gave credence to the view that oral variations in the face of NOM clauses were permissible. Oral variations could be considered contracts in themselves and such oral contracts (having the same legal status as written contracts) could vary what was in writing.

The oft-cited authority in *Beatty*, or similar principles, have been applied in Australia,<sup>4</sup> Canada<sup>5</sup> and in Germany.<sup>6</sup>

### English cases

The words of Cardozo J in *Beatty* were cited by Kitchin LJ when similarly finding MWB's NOM clause to be ineffective in the Court of Appeal's decision in *Rock Advertising*.<sup>7</sup> However, the last two decades have yielded inconsistent case law on the subject.

In 2002, Sedley LJ held in *World Online Telecom Ltd (formerly LocalTel Ltd) v I-Way Ltd*<sup>8</sup> that the law on the subject was 'not settled'. Curiously, just two years earlier, in *United Bank Ltd v Asif and anor*,<sup>9</sup> he had decided that it was 'incontestably right' that 'no oral variation of the written terms could have any legal effect' where a NOM clause existed (a

view later endorsed by the Court of Appeal). Over ten years later, Beatson LJ expressed the view (albeit *obiter*) in *Globe Motors Inc v TRW LucasVarity Electric Steering Ltd*<sup>10</sup> that NOM clauses were ineffective.

Plainly, the Supreme Court's ruling on the effectiveness of NOM clauses was much needed to settle the position.

### Supreme Court decision: reasoning

#### *No infringement of party autonomy*

In response to the view that NOM clauses cannot be effective because party autonomy dictates that parties are free to orally vary the NOM clause itself, the Supreme Court held that 'autonomy operates up to the point when the contract is made, but thereafter only to the extent that the contract allows. Nearly all contracts bind the parties to some course of action, and to that extent restrict their autonomy'. There is no reason why parties cannot bind themselves to the form of contractual variation. This was, after all, the parties' intention when agreeing the terms of the contract and does not undermine the general rule that contracts can be made informally. The notion of infringement of party autonomy in such circumstances was considered a fallacy.

#### *Provision of contractual certainty*

Further, Lord Sumption noted the frequency of NOM clauses in written agreements. Such clauses are included by contracting parties by agreement and are clearly desirable to serve legitimate business interests where the flexibility of oral amendment is not desired (ie, by providing contractual certainty). NOM clauses minimise the likelihood of employees inadvertently binding the business by oral agreement, restrict avenues for misinterpretation of amendments and limit the ability of counterparties to undermine written agreements.

#### *Parties have protection where oral variation is acted upon*

The obvious risk relating to enforcement of NOM clauses, as noted by the Supreme Court, is that a party mistakenly believes an oral variation to be binding and acts on it, but then later finds the amended provision to be unenforceable. However, strictly upholding NOM clauses does not leave such persons without recourse.

English law provides protection to those who suffer inequality as a result of reliance on an ineffective variation in the various equitable doctrines of estoppel. Similar concepts to estoppel are recognised in other jurisdictions.<sup>11</sup> It should be noted that estoppel is often only available as a defence mechanism ('used as a shield and not as a sword'<sup>12</sup>) and in specific circumstances (an unequivocal representation that the variation was valid, reasonably relied upon to a party's detriment). While this may provide some comfort to a party that has acted in reliance on the word of its opponent, in good faith, the Supreme Court was keen to stress that estoppel should not undermine the value of contractual certainty provided by upholding NOM clauses.

### Commentary

We noted at the beginning of this article that upholding NOM clauses may not, at first blush, seem to be a ground-breaking development. On further evaluation of the concept of party autonomy and the flexibility of common law, however, the debate over contractual freedom v contractual certainty is more understandable. Of further interest is the alternative judgment of Justice Briggs in *Rock Advertising*, who agreed with the leading judgment but on different grounds. He considered that parties *could* vary a NOM clause orally if they expressly referred to their wish to do so or by strictly necessary implication (a concept likely to give rise to an estoppel in any event). This view tips the scales slightly further in favour of post-contractual party autonomy at the expense (somewhat) of contractual certainty. It is possible, therefore, that Justice Brigg's view may be proffered by parties (who have orally and expressly agreed to dispense with a NOM clause) as a reason why an oral variation should be upheld, but the leading judgment of Lord Sumption is, most likely, insurmountable.

The decision in *Rock Advertising* provides significantly more contractual certainty to legal practitioners and business persons alike. It does not appear to be either onerous or unreasonable to ask parties, who have gone to the effort of putting their agreed terms into a written agreement which provides that such terms cannot be amended orally, to effect such amendment by doing what they agreed to do in the first place (ie, record their amendment in writing).

Our practical advice for clients contracting under English law would be to firstly consider whether they desire the certainty and protection of a NOM clause or the greater flexibility of oral variation. Secondly, if a variation to a written contract is sought, check for the existence of a NOM clause and ensure that is complied with. Thirdly, ensure employees are aware of their authority to vary contracts (or lack thereof) and of the contractual requirements for variation under a NOM clause. Finally, if acting under an oral variation where a NOM clause exists but has not been complied with, parties should seek to put the required written variation in place as soon as possible, remembering that estoppel may only have a limited application.

#### Notes

- 1 *MWB Business Exchange Centres Ltd v Rock Advertising* [2016] EWCA Civ 553 at [34], agreeing with Moore-Bick LJ in *Globe Motors Inc v TRW LucasVarity Electric Steering Ltd* [2016] EWCA Civ 396.
- 2 Uniform Commercial Code § 2-209(2).
- 3 (1919) 225, NY 380.
- 4 *Liebe v Molloy* (1906) 4 CLR 347 (High Court); *Commonwealth v Crothall Hospital Services (Aust) Ltd* (1981) 54 FLR 439, 447 et seq; *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1.
- 5 *Inc v Print Three Franchising Corp'n* (2003) 226 DLR (4th) 577, para 54 per Weiler JA, citing *Colautti Construction Ltd v City of Ottawa* (1984) 9 DLR (4th) 265 (CA) per Cory JA.
- 6 A Müller, *Protecting the Integrity of a Written Agreement* (2013), 300-305.
- 7 n 1 [34].
- 8 [2002] EWCA Civ 413.
- 9 (11 February 2000, unreported.)
- 10 [2016] EWCA Civ 396.
- 11 See, for example Art 29(2) of the Vienna Convention on Contracts for the International Sale of Goods (1980); article 1.2 of the UNIDROIT Principles of International Commercial Contracts, 4th ed (2016).
- 12 *Combe v Combe* [1951] 2 K.B. 215 [218].

Lianne Craig

Hausfeld, London

lcraig@hausfeld.com

## Expedited commercial trials in England: the way of the future or a flash in the pan?

England has long been internationally considered an attractive jurisdiction for commercial litigants. With its pragmatic judges, extensive disclosure regime and well-developed business law, its advantages are obvious. Notwithstanding this, English lawyers have become concerned that the length and disproportionate cost of trials hinder access to justice and encourage tactical wrangling. As such, two pilot schemes, the Shorter Trials Scheme (STS) and Flexible Trials Scheme (FTS), were introduced on 1 October 2015 for three years to address these criticisms. With both ending on 31 September 2018, this is an opportune time to examine their impact.

### How do the schemes work?

#### *Shorter Trials Scheme*

The STS is characterised by its stringent deadlines. For instance, a preliminary Case Management Conference (CMC) should

be held approximately 12 weeks after the defendant acknowledges service of the claim. Trials must be held within eight months of the CMC and should last no longer than four days. Judges should aim to hand down decisions within six weeks of the trial. That aside, speeches and cross-examination may be 'stop-clocked' and disclosure is abbreviated to an arbitration-style approach. Expert evidence is provided by written reports with oral evidence limited to identified issues.

#### *Flexible Trials Scheme*

The FTS differs from the STS in that it allows parties to adapt trial procedures to their needs. This largely involves limiting disclosure and oral evidence at trial to the minimum necessary for fair resolution of the case. If parties opt to use the scheme then there is a default flexible trials procedure, but this can be varied by agreement or by the court.

*Have the schemes been effective?*

That the schemes are not designed to apply to all commercial cases is self-evident. Indeed, English procedural rules specify that the STS cannot be used where claims contain allegations of fraud or dishonesty, require extensive disclosure or involve multiple issues and parties. In reality, this excludes a significant proportion of the complex and multi-jurisdictional caseload commonly adjudicated by the English commercial courts.

That said, the ever-increasing volume of reported cases suggests that the STS is gaining popularity. Where the dispute involves a relatively self-contained question of law and much of the evidence is documentary, the STS will plainly be beneficial. Thus, in *National Bank of Abu Dhabi PJSC v BP Oil International Limited*, a breach of warranty and misrepresentation claim worth just under US\$69m was brought to trial eight months after being commenced and was heard over one day. Total costs were approximately £350,000. Prior to the introduction of the STS, this would have been inconceivable (although the judgment has now been successfully appealed). With various other cases also demonstrating the efficacy of scheme, it would be surprising if it were now scrapped.

Conversely, the FTS has not been used since its introduction. This may be because the STS adequately addresses the need to resolve mid-range (and even some large) business disputes in a sensible time period and at reasonable cost. Moreover, in high-value and multi-faceted commercial claims, parties frequently choose to litigate in England precisely because they can obtain wide-ranging disclosure and cross-examine witnesses at length. In such cases, judges already have broad case management powers which can informally replicate aspects of the FTS if necessary.

**Commentary**

The STS, in particular, represents an opportunity for English lawyers. Financing options for claimants have dramatically increased in English proceedings in the last decade. For instance, the involvement of third party funders and insurers is now a common feature of commercial litigation. Cases suitable for the STS may be attractive for such entities given that use of the scheme should, in theory, increase certainty and remove the incentive for parties to engage in attritional tactical battles.

STS and FTS also serve as useful comparators to expedited procedures adopted in arbitration. Organisations such as the International Chamber of Commerce, the Singapore International Arbitration Centre and the Hong Kong International Arbitration Centre have, of late, been similarly keen to ensure that justice is dispensed efficiently and that parties receive value for money. However, whilst entry into their expedited schemes is usually determined by the value of the claim (with parties having the option to opt-in if the quantum is higher), the STS takes a more holistic approach. This greater nuance may be attractive for parties who would otherwise have chosen to arbitrate rather than litigate and increases England's jurisdictional competitiveness.

**Conclusion**

The STS has proved to be a resounding success and provides a procedural bridge between summary judgment and full-blown trial. It also demonstrates a desire on part of the English justice system to adapt to modern commercial realities while retaining its competitive edge. The latter has become even more important as the United Kingdom prepares to leave the European Union. On the other hand, it is clear from the lack of uptake that parties do not believe that the FTS makes litigating more efficient or cost effective. Whether it will be extended beyond the pilot stage, therefore, remains to be seen.

Lianne Craig

Hausfeld, London

lcraig@hausfeld.com

# The rise of 'hot-tubbing': the beginning of the end for expert cross-examination?

The formalised introduction of concurrent expert evidence (CEE, a process otherwise known as 'hottubbing') in the English courts, by amendment of Practice Direction 35.11 to the Civil Procedure Rules, was one of the real innovations of the Civil Costs and the Jackson Reforms of 1 April 2013.

The amendment allows for a discussion chaired by the judge in which the various experts, the parties, the advocates and the judge engage in a co-operative endeavour to identify the issues and arrive, where possible, at a common resolution. From there on, the judge is not confined to the opinion of one advisor but has the benefit of multiple advisers who are rigorously examined in public.<sup>1</sup>

However, even before the formalised procedure for hot-tubbing was born, the use of concurrent evidence was being adopted, particularly in specialist English courts, where expert evidence on highly-technical medical, scientific, engineering, or architectural matters, was commonly required. Nevertheless, as a result of Sir Rupert Jackson's reforms, the parties to various competition proceedings brought before the English courts since 2013 have likewise invoked the use (or potential use) of hot-tubbing, no doubt inspired by its use in Australian competition proceedings. It is presumably just a matter of time before the approach also becomes more mainstream in broader commercial claims before the English courts.

The Competition Appeal Tribunal (the 'CAT') and the High Court have been at the forefront of hot-tubbing in England and Wales whilst hearing competition claims. In particular, it has been used in the following competition cases of note: *Streetmap v Google*,<sup>2</sup> *BT v Ofcom*,<sup>3</sup> *Socrates Training v The Law Society*,<sup>4</sup> *Agents Mutual*<sup>5</sup> and *GSK v CMA*.<sup>6</sup> With *National Grid*<sup>7</sup> in 2014 and *Peugeot*<sup>8</sup> in 2018, the UK competition community has come tantalisingly close to seeing hot-tubbing in action in a cartel damages claim, but both cases settled shortly before trial.

Whilst the sample of cases where it has been used remains small, they have exposed some of the limitations of judge-led questioning of experts, notably in cases where there was very close interplay between factual, legal and economic analyses. In most cases leading counsel for the parties usually has a much better grasp of the facts and issues underlying a case than the judge or tribunal panel hearing it which, in turn, typically puts them in a better position to truly test in detail each expert's evidence. On the other hand, there is a worrying trend, in particular in competition claims, for experts to be (or at least to appear) increasingly partisan in favour of the party instructing them, especially in the face of aggressive cross examination by the opposing parties' barristers. Hot-tubbing can clearly play a positive role in such cases as the process of having one expert immediately comment on the views of the other, combined with the more convivial questioning from a judge who is geared towards extracting the truth rather than making the experts trip up, maximises the potential for consensus-building.

Against that background, it is worth revisiting whether the better solution going forward might be a 'hybrid' approach, combining elements of cross-examination and hot-tubbing in order to address the weaknesses of hot-tubbing alone whilst retaining its benefits. The published transcript of the pre-trial review in *Peugeot*,<sup>9</sup> and subsequent order for hot-tubbing, helpfully shed some light on how such a 'hybrid' process would have been structured had that claim proceeded to trial.

## The pre-trial review in Peugeot

The most significant topic for consideration at the pre-trial review in *Peugeot* was whether the parties' experts should exclusively be cross-examined at trial (in the ordinary way) or whether the experts should, either in lieu of or in addition to such cross-

examination, give evidence concurrently with the judge (rather than advocates) leading the questioning. A few minutes into the hearing, Mr Justice Green confirmed that he was inclined to go down the hot-tubbing route and divide the expert process into very broad categories, or free-standing parts, with cross-examination to follow each, in order to address any outstanding factual disputes. In that regard, Mr Justice Green took the view that, stripped to its bare essentials, there were only three expert issues to address in a cartel damages claim such as *Peugeot*: the baseline issue, which is volume of commerce; the overcharge issue, which is the multiplier; and the discount issue, otherwise known as pass on. As such, the hot-tubbing process in *Peugeot* embraced all the key expert issues relevant to the quantification of the claim, whilst allowing adequate time for the cross-examination of experts on each issue too.

### Comment

Given the clear advantage of having 'the best of both worlds', the approach of combining hot-tubbing and cross-examination is likely to be considered and replicated in many other claims going forward, particularly in cartel damages claims where the experts' competing econometric models invariably produce very different results and cannot, by their very nature, provide the judge with black and white answers to the key issue of quantum. Such an approach could also assist parties in

persuading more traditional, commercial law judges, who are less familiar with the concept, to try hot-tubbing in the more standard commercial cases where they are yet to be properly tested.

The pre-trial review in *Peugeot* is also a helpful reminder that hot-tubbing requires very careful consideration by the courts and careful continued case-management well before and at trial. This is the case not least because of the considerable burden it places upon judges in preparing their questions and managing the process and the potential pitfalls and injustices that could ensue if the judge is not sufficiently familiar with the expert evidence in the case at hand.

### Notes

- 1 The Hon Justice McClellan, Chief Judge at Common Law of the Supreme Court of New South Wales (as quoted by: The Academy of Experts, Concurrent evidence), available at: [www.academyofexperts.org/guidance/users-experts/concurrent-evidence-hot-tubbing](http://www.academyofexperts.org/guidance/users-experts/concurrent-evidence-hot-tubbing).
- 2 [2016] EWHC 253 (Ch).
- 3 [2016] CAT 25.
- 4 [2017] CAT 10, the first fast-track case in the CAT.
- 5 [2017] CAT 15.
- 6 [2018] CAT 4 (otherwise known as 'Paroxetine'), in which two separate 'hot tubs' were conducted, one with all the experts to cover the cartel proceedings; the second with two experts to cover the abuse of dominance proceedings. To date, Paroxetine is probably the most extensive use of the hot-tub in the English courts.
- 7 *National Grid Electricity Transmission Plc v ABB Ltd et al.*
- 8 *Peugeot S.A. and others v NSK Ltd and others.*
- 9 The transcript of the pre-trial review held in the CAT on 27 March 2018 is available at: [www.catribunal.org.uk/files/1248\\_Peugeot\\_Transcript\\_270318.pdf](http://www.catribunal.org.uk/files/1248_Peugeot_Transcript_270318.pdf)

**Dr Christoph von Burgsdorff**

Luther Rechtsanwalts-  
gesellschaft, Hamburg  
christoph.von.  
burgsdorff@luther-  
lawfirm.com

# New implications of German civil procedure

**A**t the beginning of 2018, there were some remarkable developments regarding German civil procedure. Two of these developments in particular bear great importance, not only for the legal profession but for everybody doing business on an international level as well.

Firstly, there have been efforts to establish chambers for international commercial matters in German courts. These chambers will hear cases in the English language, which may help German courts to attain more international recognition.

The second important development to be discussed in this article is the question of whether a certain jurisdiction may be agreed upon simply by the existence of a correlating usage and without a written agreement at all.

Both developments may have an impact on international business in the future and therefore need to be considered by all parties acting at an international level.

## New Chamber for international commercial matters

The language in German courts has always been German. German law even states that it is mandatory that the trial be held in German. However, this often deters internationally-operating businesses from opting for German courts to resolve their disputes. This issue has grown more apparent in recent years. In order to become more attractive as a jurisdiction, the regional court of Frankfurt on the Main established the first English speaking court chamber in Germany in 2018. However, German procedural law only allows the oral proceedings to be in a language other than German. Legal documents like submissions to the court and motions need to be in German. Nonetheless, this chamber of the regional court in Frankfurt on the Main was met with a very positive reception.

The German legislator has acknowledged the increasing number of voices demanding the establishment of a full fledged English-speaking chamber and has taken action. The *Bundesrat* (the upper house of the German

Parliament) has passed a bill that opens up the old rules and enables courts to establish chambers for international commercial matters. These chambers may conduct proceedings in English without the need for any German correspondence. The legislator aims to make Germany more attractive for parties acting internationally. The draft bill is currently pending in the *Bundestag* (parliament). When the draft bill has passed, the *Bundestag* and the changes have entered into force, international parties will be able to proceed in English rather than in German.

Whether the new chambers for international commercial matters actually increase the attractiveness of German courts at an international level, or even enable certain German courts to become a judicial focal point in Europe, remains to be seen. However, the advantages an English speaking chamber may provide to international parties are clear. The parties themselves will feel more comfortable if they can understand the language of the proceedings without having to rely on translations. Hence, it will be much easier for the parties to follow the proceedings and even take part in them. This also applies to foreign lawyers, thus facilitating the cooperation between German and foreign lawyers during the proceedings. In addition to this, there will be no more need to translate important documents such as contracts, thus allowing a direct interpretation of their terms.

## Establishing jurisdiction without written agreement through usage

Besides the pending establishment of chambers for international commercial matters, a recent decision by the *Bundesgerichtshof* (German Federal Court of Justice) has had significant implications for international businesses.

The disputing parties had concluded an agreement regarding the transport and assembly of installations. The parties were based in different countries, namely Germany and Austria, which is why international jurisdiction was a matter of importance.

The defendant had orally accepted the claimant's offer, which he had received by email. The offer contained stipulations regarding jurisdiction as well as the applicable law. Invoking the provisions included in the offer, the claimant asserted its claims before German courts. The defendant challenged the jurisdiction of the German courts.

The *Bundesgerichtshof* decided the jurisdiction issue in April 2018 and reached two important conclusions that may impact a number of international players. Firstly, the *Bundesgerichtshof* stated that an oral acceptance of an offer made by email in general is not sufficient to establish an agreement on jurisdiction. European law states that, as a general rule, such agreements need to be in writing or evidenced in writing. Case law of the Court of Justice of the European Union and other high national courts suggests that there are certain cases in which forms other than the written form may suffice. However, case law generally requires some form of embodied evidence such as emails from both sides or a written statement by the defending party. The *Bundesgerichtshof* pointed out that the oral acceptance of an offer received by email does not meet these requirements.

German courts may nonetheless be competent if an according usage is in place. The *Bundesgerichtshof* made it clear that an agreement on jurisdiction does not need to be in writing if such practice is commonly known and used within a certain sector. That such usage exists was nothing new: it is even stated in European law. However, beyond that the *Bundesgerichtshof* asserted that the court itself is obliged to evaluate whether such usage in the relevant sector exists. If there is indication that such usage exists, the court has to determine whether or not that is actually the case, especially if one of the parties claims that such usage exists.

This decision, which may seem to be of little consequence, may have considerable influence on certain sectors. According to the *Bundesgerichtshof* the courts are free on how they determine whether a usage applies or not. This means that parties may successfully claim that an agreement on jurisdiction was made even though there is no written evidence of such agreement. But they may do

so without having to prove by themselves that such usage applies.

The fact that it is the court who has to determine the usage's existence in a certain sector can have a considerable influence on further practice. In particular, the prospect of divergent decisions of courts regarding the same sector is troublesome. This may, to a certain extent, cause legal uncertainty. The decision of the parties regarding jurisdiction may be influenced by previous case law on this matter. On the other hand, this opens up the possibility for parties to choose specific courts depending on how lenient their decisions have been in the past. And even if there was no such divergence, future decisions especially by higher courts will most certainly influence the common practice itself.

However, this leniency of the *Bundesgerichtshof* regarding the assertion of a usage only applies to agreements on jurisdiction. Other agreements, such as an arbitration clause, may not be entered-into on grounds of an international usage. This was just recently confirmed by the *Bundesgerichtshof* in another decision in April 2017.

## Summary

The two aforementioned developments in German procedural law may significantly influence international business. Internationally-acting companies and businesses should consider the possibilities opened up by these developments regarding litigation in Germany. With the establishment of the chambers for international commercial matters, English-speaking parties will be less deterred from choosing Germany as a place of jurisdiction. Internationally-acting businesses will be able to see the various advantages of German state courts and will benefit from them without having to rely on translations.

In addition, the aforementioned procedural matters show that German civil procedure holds a number of options for internationally-acting parties. The decision described above is only one example of the possibilities which should be considered by parties and which may influence, not only civil procedure, but also contractual drafting at an international level.

**Thomas  
Wambach**

Heuking Kühn Lüer  
Wojtek, Hamburg  
t.wambach@heuking.de

# Mass litigation in Germany: the current situation and perspective

## Current situation in Germany

In the last couple of years, several situations have come to the public's attention. These have one similarity, despite the diverse legal issues that were at stake: an unknown number of persons were affected by allegedly wrongful acts committed by one defendant, particularly a big company. All these cases have in common that the individual suffered comparably minor damages, while the combined damages amount to hundreds of millions if not billions of euro. In such cases a cost-benefit assessment frequently leads to rational apathy, meaning that the harmed individual refrains from taking legal action because the potential benefits do not significantly exceed the costs of such activity. Prominent cases are and were the Deutsche Telekom IPO, the issuance of Lehman Brother debenture bonds and the truck cartel. Currently, the Volkswagen Diesel affair takes this phenomenon to a whole new level. Worldwide, some 11 million cars were affected by an alleged defeat device Volkswagen installed to meet European and United States emission standards. In Germany alone, some 2.8 million cars were equipped with the alleged defeat device.

Although the published numbers of Volkswagen cases that are pending before the German courts are conflicting,<sup>1</sup> it is safe to say that it is a wave Germany has never seen before. Even if only ten percent of the affected German customers would file complaints, the number of diesel affair-related cases would be almost equal to all cases filed with German district courts in recent years.<sup>2</sup> With advanced data processing technology, specialised law firms are able to file thousands of cases within a couple of weeks or even days. This had been impossible with the technology of the second half of the 19th century, when the German Code of Civil Procedure (*Zivilprozessordnung* – ZPO) came into force and was not even possible with the technology of the late 20th century.

The German legal system is not prepared to deal with such a massive number of cases. German procedural law neither provides for a class action, nor a sample proceeding that would be binding for all pending cases with a similar set of facts. Such sample proceeding only exists for capital investors who claim that there was wrongful, misleading or incomplete capital market information that influenced their – mostly failed – investment.<sup>3</sup> Consequently, each affected customer has to file an individual law suit against the alleged injuring party.

Moreover, there is no uniform practice at district court level when it comes to the diesel affair. While some judges have found in favour of the plaintiff asserting that Volkswagen committed fraud against its customers, other judges dismissed the complaints, holding that the plaintiffs failed to meet the necessary standard of proof or to show actual damage. So far, there has not been an appeal to the German Federal High Court (*Bundesgerichtshof* – BGH). It has therefore not ruled in the Diesel affair so far.

The current situation can thus be described as follows:

- Only a small fraction of affected customers has filed complaints.
- Nonetheless, the districts courts are already overloaded.
- Those who want to take legal action have to bring individual lawsuits.
- The heterogeneous rulings undermine trust in the fairness and predictability of the German judicial system.

## Activities by the German Legislature

In view of this situation, and even before the diesel affair, the German Ministry of Justice drafted a bill in the last legislative period with the goal of establishing a sample proceeding for cases outside the area of wrongful, misleading or incomplete capital market information. This draft bill did not even

find a majority within the ruling coalition between Christian Democrats (CDU) and Social Democrats (SPD). This situation has changed in the current legislative period, despite the fact that the same parties form the government. This bill is now part of the coalition agreement. The ruling coalition agreed to pass the law in November 2018 at the latest, just before the limitation period for the Diesel cases lapse. The limitation period will expire at the end of 2018.

The draft bill has the following key elements:

Qualified institutions may file a motion for a declaratory judgment if the factual or legal requirements of a claim or a legal position between consumers and enterprises are in dispute.<sup>4</sup>The draft bill's applicability is not limited to specific subject matters.

The action is admissible if the plaintiff shows that more than ten consumers are affected by the violation and more than 50 consumers have registered their claims within two months of the action being published in the complaints register that will be established for that purpose at the German Federal Office for Justice (Bundesamt für Justiz).<sup>5</sup> This proceeding is similar to the already-mentioned sample proceeding in matters of wrongful, misleading and incomplete capital market information: first, the motion has to be filed, showing a minimum of ten affected consumers. The motion is then published.<sup>6</sup> The consumers may then register their claims with the German Federal Office for Justice (opt-in model).<sup>7</sup> If 50 claims are registered within two months of publication of the motion, the court will proceed. Otherwise the motion will be dismissed.

Once the action for declaratory judgment is pending, no other sample action with the same factual or legal questions can be filed.<sup>8</sup> Furthermore, no consumer may initiate an individual lawsuit against the enterprise based on the same set of facts dealing with the same legal issues.<sup>9</sup> The registration of a claim suspends the statute of limitation as of the date of filing of the sample complaint, hence having a retroactive effect that benefits the consumers.<sup>10</sup>

Unlike US class actions, the sample proceeding does not aim at granting individual relief. It shall only facilitate the subsequent individual lawsuit by the consumer.

If the cases are not settled, the ruling by the court will be published in the complaints register and shall be binding upon the parties

and all registered consumers as far as the declaratory judgment resolved the issues that were subject to the proceeding and the consumer has not withdrawn his registration.<sup>11</sup>

Unlike sample proceedings dealing with wrongful, misleading, or incomplete capital market information, it is the lower district courts which shall have jurisdiction to hear sample proceedings in consumer matters and not the regional appellate courts. The ruling might be appealed to the regional appellate courts and afterwards to the German Federal High Court (BGH). While the regional appellate courts review questions of law and facts, the German High Court's review is limited to legal errors.

The draft bill has been passed by the German legislature (Bundestag) in June 2018 and shall come into force as planned on 1 November 2018.

### Comments and perspective

In short, there are two ways to address the problem of mass litigation: (i) either a multitude of claims is bundled in a class action where all claims are resolved by one ruling or settlement or (ii) a sample proceeding is established where – on a more abstract level – all relevant questions of law and fact shall be decided. In the latter model, all affected consumers still have to pursue their claims in individual lawsuits, unless there has been a settlement. This raises the question of why the German lawmaker did not opt for a class action like the one in the US that grants – if successful – relief to all affected consumers. The suspected reason was the fear of a litigation industry that benefits attorneys who are specialised in mass litigation and collect enormous contingency fees. As it is true that the model passed by the German legislature does avoid high profits for lawyers on the level of the sample proceedings, it does not prevent the rise of a litigation industry in Germany. Such industry already exists. Under German law, an attorney is compensated on a case-by-case basis. The fee for the case is set forth by a statutory compensation scheme.<sup>12</sup> The amount of compensation depends on the value of the subject matter and the procedural activities. It is fair to assume that the compensation in a diesel affair case is about €2,000 (excluding additional fees in case of appeal or settlement). Considering that some of the consumers' counsels claim to represent up to 40,000 clients, a very careful calculation ends with a rough figure of €80m fee revenue.

Because of the current data processing technology, the amount of work that has to be put into a standard case is limited.

Although the new sample proceeding for consumers will help consumers to pursue their rights by resolving some of the issues at stake with binding effect for the enterprise, other pressing issues have not been addressed: The sample action does not grant an individual remedy: each consumer still has to file his own complaint to obtain an award in his favour. Consequently, the court system will not be relieved. The litigation industry will not cease to exist but will perhaps thrive even more, because the resolution of some decisive issues by a sample proceeding will facilitate the preparation of the pleadings in subsequent lawsuits.

**Notes**

- 1 According to the leading German databank for lawyers Beck.de, insiders assume that there are some 15,000 cases pending. At the same, time there has already been one complaint filed by myright, a provider of legal services, that comprises more than 15,000 assigned claims. Two of the law firms that represent Volkswagen customers maintain that they have each

- retainers from some 40,000 clients. One of those firms alleges to have filed more than 6,000 individual lawsuits on behalf of customers.
- 2 According to the German Federal Office for Justice (*Bundesamt für Justiz*) there were 321,996 new complaints filed on the district court level (*Landgerichte*) in 2016.
- 3 See sec 1 para (1) Law about Sample Proceedings for Capital Investors (*Kapitalanleger-Musterverfahrensgesetz* (KapMuG)).
- 4 See draft sec. 606 para (1) German Code of Civil Procedure (ZPO). A qualified institution has to have (i) either ten associations or 350 persons as members, (ii) has to be registered for at least four years as organization that has standing to file complaints in the interests of consumers, (iii) has the protection of consumer interest as purpose of the association, (iv) does not pursue sample proceedings to make profits, and (v.) does not receive more than five percent of its revenues as donations from enterprises.
- 5 See draft sec. 606 para (3) German Code of Civil Procedure (ZPO).
- 6 See draft sec. 607 para (1) German Code of Civil Procedure (ZPO).
- 7 See draft sec. 608 para (1), (3) German Code of Civil Procedure (ZPO).
- 8 See draft sec. 610 para (1) German Code of Civil Procedure (ZPO).
- 9 See draft sec. 610 para (2) German Code of Civil Procedure (ZPO).
- 10 See draft sec. 204 para (1a) German Civil Code (BGB).
- 11 See draft sec. 612 para (1), 613 (1) German Code of Civil Procedure (ZPO).
- 12 See Bill for the Compensation of Attorneys (*Rechtsanwaltsvergütungsgesetz – RVG*).

**Nicolas Ollivier**

LALIVE, Geneva  
nollivier@lalive.law

**Grégoire Geissbühler**

LALIVE, Geneva  
ggeissbuehler@lalive.law

# Swiss courts dismiss foreign currency claims if the currency of the prayers for relief is wrongly denominated

Swiss law is often chosen by foreign parties to govern their contractual agreements, mostly due to Switzerland’s stability and neutrality, its well-established case law and its highly liberal legal system which allows parties to shape contracts with little restriction. Nowadays, companies can easily open sub-accounts in different currencies to do business and convert currencies to make payments. Furthermore, anyone can readily access historical exchange rates which are available online and thus determine the value of any amount in different currencies. This could suggest that little or no attention is paid to the currency in which a monetary claim is denominated when a dispute arises.

Despite these facts, the Swiss Supreme Court case law on foreign currency claims is strict. Where a debt is in foreign currency, the creditor may assert its claim – whether contractual or tortious – only in that currency.<sup>1</sup> The creditor must express its claim for relief in the ‘effectively due currency’.<sup>2</sup> The mere fact that Swiss courts have jurisdiction and/or Swiss law is applicable is not sufficient to conclude that a monetary claim can be denominated in Swiss francs. The consequences can be dire, as a claim denominated in the wrong currency will be dismissed, irrespective of its merits. The Swiss Supreme Court held that allowing a claim in another currency would be a decision

*extra petita* – which is prohibited by the Swiss Civil Procedure Code ('SCPC')<sup>3</sup> – as, in conception, a claim in Swiss francs and a claim in US dollars are different by nature (*aliud*), irrespective of their actual values. The claimant is not barred from re-filing its claim in the correct currency, as the decision only deploys *res iudicata* regarding the wrong currency used. This approach is consistent with the idea that the nature of the two claims is different, but may prove costly. The claimant will have to renew his/her claim (and make a new advanced payment for court costs) while still having to bear the court costs and party costs of the previous proceedings. This also leads to a significant increase in the length of the proceedings, especially in complex litigation.

This article aims at outlining the applicable rules for determining the currency of a claim, the difficulties that a claimant may face in certain contractual settings, the solutions that counsel can use to mitigate the risks and which procedural tools are available when a claim has been filed in the wrong currency,

### The rule of the effectively due currency

As a rule, the claim must be denominated in the 'effectively due currency'. However, this notion remains difficult to define. The Swiss Supreme Court held that:

'claims for contractual damages are not necessarily to be denominated in the currency of the contract. They must in principle be drawn up in the currency of the State in which the patrimonial damage occurred. Depending on the circumstances, the currency of the contract may remain determinative, particularly where damages replace a contractual payment obligation (eg, salary, fees, license fees)'.<sup>4</sup>

As a result, a bank responds in US dollars to a loss suffered by its client in relation to options denominated in dollars and whose profit should have been realised in US dollars.<sup>5</sup> In the same vein, the seller who does not fulfil his/her obligations must compensate in Deutsche Mark the lost profit suffered by the buyer who would have resold the goods in Germany.<sup>6</sup>

For a long time, the courts of some Swiss cantons had shown a certain tolerance regarding the currency mentioned in the prayers for relief for a claim for payment, when this was uncertain: the claim could be denominated in foreign currency, in foreign

and Swiss currencies, or even only in Swiss francs if debt collection proceedings had been previously filed. The Swiss Supreme Court put an end to this practice in 2008 and 2010 judgments.<sup>7</sup> The principle of the 'effectively due currency' has since then been strictly applied by all Swiss courts. Consequently, claimants must be particularly cautious when analysing which currency (or currencies) may be validly claimed, as defendants may prevail when the wrong currency is claimed.

Where contracts directly stipulate the currency of the obligation, it is usually easy to determine the 'effectively due currency'. For instance, a claim pertaining to a letter of credit, loan or a bank guarantee stipulating an obligation in US dollars must be denominated in that currency. However, as stated above by the Swiss Supreme Court, claims for contractual damages are not necessarily denominated in the currency of the contract. An analysis on a case-by-case basis is therefore necessary to ascertain whether the currency of the contract corresponds to the currency in which or where the damage occurred. If there is a discrepancy, a diligent counsel must articulate the claim in each and all relevant currencies.

Furthermore, certain contracts do not stipulate the currency of the contract. In such cases, a claimant must be particularly cautious when determining the currency in which he/she denominated his/her claim. In a case, a claimant argued that he and a Swiss bank, established a partnership in which he brought his experience of the business world and the Turkish market by identifying opportunities to enter into transactions for the purchase or sale of goods for the bank, which in turn handled the administrative management and provided the financing necessary for the conclusion of these transactions. The profit generated by these transactions was split equally between them. His share was paid into an account opened in the bank's books. The amounts he claimed payment for corresponded to the amount shown on that account, namely \$1,051,116, the equivalent of which in Swiss francs represented CHF1,217,286. The claim filed for CHF1,217,286 was dismissed on the grounds that this was not the correct currency. The Geneva Supreme Court held that Article 84 of the Swiss Code of Obligations ('CO') governs the currency of payments of all of pecuniary debts. Under this provision, a party making a foreign

currency claim in Switzerland is required to make a claim for payment in that currency. If the claimant wrongly makes a claim in Swiss francs, his/her claim must be rejected, as the debtor cannot be sentenced to pay something other than the original debt due. The judge cannot thus deviate from the prayers for relief for a payment claim denominated in Swiss francs and substitute a sentence in foreign currency.

In banking litigation, the matter is even more complex. Banking agreements pertaining to the execution of transactions may be denominated in various currencies and/or the sale and purchase of financial products involving several currencies, such as general conditions relating to the banking relationship, deposit agreements, master agreements for foreign exchange over the counter (OTC) transactions and put and call options on currencies and metals. Furthermore, discretionary asset management agreements and advisory agreements often stipulate a 'reference currency'. This does not necessarily correspond to the currency in which the investments are carried out. Indeed, the assets are generally placed in financial products issued in (or related to) different currencies, in order to avoid the concentration of the portfolio on a single currency and thus to diversify the risks.

In this context, the principle of the 'effective due currency' varies depending, in particular, on the applicable rules to calculate the damage, the specific breach(es) of contract, and whether the risk of exchange rate fluctuation was accepted by the client.<sup>8</sup>

In asset management disputes (discretionary asset management agreement and advisory agreement providing for an ongoing monitoring of the portfolio) a distinction should be made in relation to two types of contractual breach: 1. a breach relating to the investment strategy (mismanagement/wrong advice in relation to the portfolio as a whole); and 2. a breach pertaining to certain individual investments (mismanagement/wrong advice confined to a part of the portfolio). In the case of the first, the damage calculation must cover the entire portfolio and the use of an hypothetical portfolio is admissible. As the client's portfolio is generally managed in a so-called 'reference currency', the damage should be calculated in this currency and the prayers for reliefs should, in turn, be denominated in the same one. In the second case, the damage computation should be limited to the particular investments (concrete calculation of

the damage). In principle, the currency of the non-compliant transaction is the one in which the claim must be denominated (eg, if the disputed transactions are shares denominated in US dollars, the claim is to be denominated in US dollars also). However, where more complex transactions are disputed, for example, exotic options including multiple transactions in various currencies, this principle cannot be strictly applied. The court should then take this fact into account and show some flexibility in its decision on the basis of Article 42(2) CO which allows the court to estimate the damage at its discretion. In addition, when there is a discrepancy between the currency of the disputed transaction and that of the debited sub-account, there is a need to determine whether the client accepted the risk of exchange rate fluctuation.

### Procedural toolkit

To mitigate the risk of the claim being dismissed, counsel to the claimant can take so-called 'subsidiary prayers for relief', for example, first claiming the amount denominated in Swiss francs, then – if and only if the first claim is rejected – damages in US dollars, then in Euros, etc. Such 'waterfall' prayers for relief are allowed by Swiss law, but the claimant should precisely calculate the damage in each and all currencies and carefully consider which currencies to exclude.

If, during the course of the proceedings, it appears that the claim for relief has been denominated in the wrong currency, all is not necessarily lost. The amendment of the prayers for relief may be possible, depending on the stage of the proceedings. Before the first main hearing, the amendment will be granted if there is a factual connection between the actual and the new claim (Article 227 SCPC). Such a connection is, in our experience, always given when only the currency is changed, as the factual background of the case remains the same. After the main hearing, the amendment needs to be based on new facts or new evidence (Article 229 SCPC). In principle, it is too late to amend the currency in which the statement of claim has been filed. In our view, a way of fulfilling this condition would be to require an expert report on the damage calculation including the currency of the damage, thus ensuring that no mistake is made in this regard and allowing for an amendment of the claim if needed.

## Conclusion

The choice of the currency is crucial in Swiss litigation. Counsel for claimant must carefully evaluate the factual background of the case and refer to precise case law to determine which currency is ‘effectively due’. There are a few possibilities to correct a wrong choice of currency if the proceedings are not at an advanced stage. It is however easier to anticipate and take subsidiary prayers for relief so as to overcome the pitfalls of the strict application of Swiss law. When defending, counsel should carefully review

the choice of currency made by the claimant, as it can also prove to be a fatal weapon: a claim denominated in the wrong currency can be derailed.

### Notes

- 1 Swiss Supreme Court, ATF 134 III 151 and ATF 137 III 158.
- 2 Swiss Supreme Court, 4A\_341/2016.
- 3 Art. 58(1) of the Swiss Civil Procedure Code.
- 4 Swiss Supreme Court, TF, 4A\_341/2016.
- 5 Swiss Supreme Court, TF, 4C\_191/2004.
- 6 Swiss Supreme Court, ATF 47 II 190.
- 7 Swiss Supreme Court, ATF 134 III 151 and ATF 137 III 158.
- 8 OIllivier/Geissbühler, ‘La monnaie des conclusions dans les litiges bancaires’ (AJP/PJA December 2017) 1439.

# Forum-running: Switzerland takes the lead

Christian Oetiker

VISCHER, Basel

coetiker@vischer.com

The Swiss Federal Supreme Court reduces the requirement for legitimate interest in a declaratory judgment in an international context and thereby allows proceedings to be moved to Switzerland by means of actions for negative declaration.

## Foreclosing effect of *lis pendens*

One of the primary concerns of European (and Swiss) international civil procedure law is to avoid, as far as possible, parallel proceedings regarding the same disputed subject matter. Indeed, the Swiss Federal Supreme Court has stated on various occasions that avoiding conflicting judgements is a matter of public policy.<sup>1</sup>

One of the tools for avoiding conflicting judgments is the foreclosing effect of *lis pendens*. Once they have been formally commenced, court proceedings foreclose subsequent court proceedings on the same matter within Europe. This effectively impedes courts from rendering different, possibly contradictory, judgments on the same matter. This principle is enshrined in Article 27 of the Lugano Convention (LC),<sup>2</sup> in Article 9 of the Swiss Private International Law Statute (PILA), and in Article 64 of the Swiss Civil Procedure Code (SCPC).

## Forum-running

The foreclosing effect of *lis pendens* gives additional weight to the forum that decides on the case. Indeed, at least in an ideal world, there should only be one court that decides on the merits of the case, and the judgment of this court should be recognised in other states.

As a consequence, if proceedings are threatened and there are several courts that could claim jurisdiction for that case, the parties will be eager to submit their dispute to the court they deem to be the most appropriate for their interests (which will often be their home court). While the claimant can in fact choose the court in which he brings the claim, the defendant is subject to the claimant’s choice. Hence, the defendant may be tempted to take the appropriate steps to bring such proceedings to a court it deems convenient. Because of the *lis pendens* rule and its foreclosing effect, it will need to do so before the claimant starts proceedings. If this undertaking is successful, the claimant will no longer be able to bring its claim in the forum of their choice. This is referred to as forum-running.

Sometimes, the defendant does not choose the court it deems most appropriate for its case, but simply opts for a particularly slow court in order to delay a possible judgement against it. The term torpedo action is often applied to this type of behaviour.

The most common method for forum-running is an action for negative declaration: for example, a party threatened with an action for performance in England sues the threatening party for declaration that the claim at issue does not exist before the Swiss courts. As a result of the foreclosing effect, such a negative declaratory action excludes a subsequent positive action for performance on the same claim.

### Particular interest in declaratory relief

Under Swiss civil procedure law, a legitimate interest in the proceedings is a prerequisite for litigation (Article 59(2) (a) SCPC). Many years of Swiss Federal Supreme Court case law have established that, for declaratory actions, a particular interest in a declaratory relief is required: the claimant must have a material interest that is worthy of protection in the immediate determination of the legal position. This requires that the legal relationship between the parties is uncertain, that such uncertainty can be lifted only by a court and that the claimant cannot be expected to accept the continuance of such uncertainty since it impedes its freedom of action. The interests of the creditor have also to be taken into account.<sup>3</sup>

The hurdles to meet these requirements were quite high and largely excluded forum-running in Switzerland. Indeed, the Swiss Federal Supreme Court had expressly held that the mere interest of one party in choosing the court of jurisdiction that suits it is not recognised as a legitimate interest in declaratory judgment worthy of legal protection.<sup>4</sup> An unreasonable continuation of legal uncertainty was to be denied by the courts whenever an action for performance was expected in the near future. This is always the case in the circumstances described here, in which one party expects the other party to file an action for performance and, for that reason only, wants to file an action for negative declaration at a different (preferable) court. Hence, forum-running in Switzerland was not possible because the courts would not render a judgment on the merits due to the lack of a legitimate interest in the proceedings.

### New approach to legitimate interest

In a current decision, the Swiss Federal Supreme Court has overturned this case law, at least for international cases.<sup>5</sup>

### Not governed by the Lugano Convention

The first question that the Swiss Federal Supreme Court considered was the applicable law. Indeed, the appellant argued that, contrary to the Court's earlier decision in DFSC 136 III 523, the question of whether a particular legitimate interest was required was not governed by national law, but by the Lugano Convention.<sup>6</sup>

The Court referred to the ECJ decisions *Folien Fischer*<sup>7</sup> and *Kongress Agentur Hagen GmbH*.<sup>8</sup> It also stressed that most Swiss commentators share the position expressed in DFSC 136 III 523, that national law governs the question of sufficient legitimate interest.<sup>9</sup>

The Court reiterated its earlier position that the scope of the Lugano Convention is limited to the issues of jurisdiction, recognition and enforcement. It found that the Convention does not contain an autonomous definition of the legitimate interest required for actions, for which the jurisdiction is based on its provisions.<sup>10</sup>

### Lex fori applies

With regard to applicable law, the Swiss Federal Supreme Court needed to decide on the question of whether the requirements for requesting negative declaratory relief are procedural or substantive in nature. The Court referred to the enactment of the Swiss Civil Procedure Code in 2010, which rendered earlier case law – pursuant to which the question was substantive in nature – inoperable. It found that, by including the negative declaratory relief in the Civil Procedure Code (Article 88 SCPC), the legislator had made a statement in favour of its procedural nature, at least with regard to the required legitimate interest worthy of protection (*Rechtsschutzinteresse*). The Court concluded that the question of whether a request for negative declaratory relief requires a particular legal interest is governed by the *lex fori*.<sup>11</sup>

### Interest in securing a sufficient place of jurisdiction

Hence, the Swiss Federal Supreme Court examined the question of whether under Swiss procedural law, the interest in securing a specific place of jurisdiction is a sufficient legitimate interest.

The Court confirmed that the three general requirements established in long-standing case law apply. Hence, a request for negative declaratory relief requires, in particular, that the legal relationship between the parties

is uncertain and that only a court can lift such uncertainty. The Court acknowledges that these requirements are usually fulfilled in situations in which the defendant wants to secure a place of jurisdiction. Hence, the third requirement, namely that the claimant cannot be expected to accept the continuance of such uncertainty since it impedes freedom of action, becomes pertinent.<sup>12</sup>

The Court stressed the fact that an action for negative declaratory relief by the (presumed) debtor does not negatively affect the creditor's position since he is prepared to commence court proceedings anyway. It also rejected the creditor's argument that being prepared to commence proceedings in England would not be the same as being prepared to do so in Switzerland, in view of the different levels of preparation for launching a claim.<sup>13</sup>

Furthermore, the Court openly acknowledged that the high threshold for legitimate interest in a declaratory judgement under Swiss law did not impede the phenomenon of forum-running, but only rendered it impossible for Switzerland. The effect of this was that the parties that could avail themselves of a Swiss forum were disadvantaged by international standards. It also recognised that the factual interest of conducting proceedings in one, rather than in another, country may be important because of the differences in the applicable procedural rules, the language of the proceedings and their costs.<sup>14</sup>

### *Possibility of torpedo claims?*

The Swiss Supreme Court also considered whether recognising the interest in securing a place of jurisdiction as legitimate would lead to a further (undesirable) option for torpedo claims. The Court acknowledged that torpedo claims are not desirable, but was also very clear that Switzerland (or any other EU or LC Member State) could not tackle the issue by imposing strict rules on legitimate interest. Furthermore, it stressed that Swiss courts are not known for overly-lengthy proceedings and that there was no substantial risk of creating a Swiss torpedo.<sup>15</sup>

### *The Court's conclusion*

These considerations led the Federal Supreme Court to conclude that a party's interest in securing a place of jurisdiction acceptable to that party for forthcoming court proceedings is now sufficient as a legitimate interest in legal protection, subject to abuse of rights. It is

therefore now possible to bring impending legal proceedings in a foreign action into Switzerland by means of a negative declaratory action.

### **Conciliation proceedings constitute *lis pendens***

A specific feature of litigation in Switzerland is that each court action must be preceded by conciliation proceedings pursuant to Article 202-212 of the SCPC. These proceedings may be commenced quickly, since they do not require a fully-reasoned statement of claim. Rather, when the conciliation authority receives a request, it summons the parties to the conciliation hearing, allowing the respondent to submit an (optional) written response. After the conciliation hearing, the claimant has three months to initiate the court proceedings.

In the present context, it is important that Swiss conciliation proceedings under the Lugano Convention constitute the *lis pendens* of the action. This was found by an English Court<sup>16</sup> and will allow a party threatened with court action abroad and wanting to move these proceedings to Switzerland to act very quickly, without the need to file an action that has already been fully substantiated.

### **Conclusion**

Overall, the Swiss Federal Supreme Court's new position has, with one stroke, rendered Switzerland very attractive for avoiding proceedings at an unsuitable foreign forum and as an alternative forum for the matter. There is no danger that this will create Swiss torpedo actions as the Swiss courts will deal with actions for negative declaration in their usual swift manner.

#### **Notes**

- 1 DFSC, 26.2.2105, 4A 374/2014, c. 4.2.1, with references.
- 2 The same principle is included in Art. 29 of the EU Regulation No 1215/2012. However, it does not apply to Switzerland.
- 3 DSFC 136 III 523, c. 5; 131 III 319, c. 3.5; 123 III 414, c. 7.b.
- 4 DFSC 136 III 523, c. 6.4; 131 III 319, c. 3.5.
- 5 DFSC 144 III 175, c. 5.4.
- 6 DFSC 144 III 175, c. 3.1.
- 7 25.10.2012, C-133/11, para. 22 and 24.
- 8 15.05.1990, C-365/88, para. 17.
- 9 DFSC 144 III 175, c. 3.2.
- 10 DFSC 144 III 175, c. 3.2.
- 11 DFSC 144 III 175, c. 4; DFSC, 23.9.2011, 5A\_88/2011, c. 4.
- 12 DFSC 144 III 175, c. 5.2.1.
- 13 DFSC 144 III 175, c. 5.2.2.
- 14 DFSC 144 III 175, c. 5.3.2.
- 15 DFSC 144 III 175, c. 5.3.3.
- 16 *Lehman Brothers Finance AG v. Klaus Tschira Stiftung GmbH* [2014] EWHC 2782 (Ch).

Virginie Reynès

DGFLA, France

vreyne@dgfla.com

# France: the creation of an international chamber specialised in cross-border disputes within the Paris Court of Appeal

Paris is a leading place for international business law and it has all the necessary means to demonstrate this. Indeed, by a protocol signed on 7 February 2017 in the presence of the French Minister of Justice, an international chamber dedicated to disputes relating to international commercial contracts was created within the Paris Court of Appeal (CICAP), the purpose of the protocol being to set forth specific rules of procedure for the cases referred to the Chamber (the 'Protocol'). By a protocol signed the same day, similar modalities were defined for the functioning of the International Chamber of the Paris Commercial Court, created in 1995 under the name of the 'Chamber of International Law'.

Alongside international arbitration, a field in which Paris is a key player (as the seat of the Court of Arbitration of the International Chamber of Commerce (ICC) since 1923) France has demonstrated its willingness and capacity to receive and handle international trade disputes, at a much lower cost of proceedings than the main common-law jurisdictions with which Paris is willing to compete.

## Background to the creation of the International Chamber

On 23 June 2016, the citizens of the United Kingdom voted in favour of their country leaving the European Union. The UK withdrawal procedure was officially launched on 29 March 2017 by British Prime Minister Theresa May.

Unless negotiations adjust to the consequences of the UK leaving the European Union, in time decisions rendered by English courts will no longer benefit from the system of automatic recognition and

enforcement of judgments provided by the Brussels I Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters recast by the Brussels I bis Regulation, which came into force on 10 January 2015. In other words, a judgment rendered by an English court will have to be the object of an exequatur procedure in order to be enforceable in the other Member States.

This will inevitably impact the attractiveness of the English courts, which today handle a very large number of international cases in business law in general, and in financial law in particular, often in application of a jurisdiction clause. Thus, as pointed out by Catherine Champrenault, Attorney General at the Paris Court of Appeal, 'it has been estimated that the legal services market, applied only to commercial cases, represented a turnover of 16 billion euros across the Channel in 2016'.

The attractiveness of the English courts, while undeniably due to the competence of their judges, also owes much to the attractiveness of London's position within the European Union, which gives its courts' rulings very easy access to the other EU member states.

Paris therefore had a strong card to play, which required a quick reaction. On 7 March 2017, the Minister of Justice referred the matter to the Paris Financial Centre High Committee (HCJP), chaired by Mr Guy Canivet, Honorary First President of the French Supreme Court (*Cour de cassation*) which submitted its report on 3 May 2017. Consequently, the HCJP recommended the establishment of international commercial chambers within the Commercial Court of Paris and the Paris Court of Appeal for the handling of international business disputes.

Paris had the credentials to position itself in this area. Indeed, in the legal field, numerous reforms have been carried out to modernise the applicable legislation, such as the reform on contract law, the general regime and the proof of contractual obligations. Paris is also a leading financial place in the euro zone, with no less than four banks ranked in Europe's top ten and three insurance companies among the world's top 25. Paris is also a major market for bond issuance in continental Europe and a leading asset management centre in the region, with €3,600bn euros under management, the highest volume after London. The demand for specialised courts is therefore self-evident.

The reactive way in which these chambers were set up was also an essential element in their success, since other European places also mentioned their willingness to create courts dedicated to international trade. It should also be recalled that other States already offer this type of specialised business-oriented jurisdiction. Such is the case for Dubai with the Dubai International Financial Centre (DIFC), or Singapore with the Singapore International Commercial Court (SICC).

This is now implemented: since 1 March 2018, the International Chamber of the Paris Court of Appeal has indeed effectively become operational. The equivalent chamber within the Paris Commercial Court has, in fact been, in operation (rather discreetly) for much longer, since 1995.

### **Cases under the jurisdiction of the International Chamber**

The CICAP has jurisdiction over transnational commercial disputes. In particular, the International Chamber shall be competent to hear disputes related to:

- international commercial contracts and the termination of commercial relations;
- transport;
- unfair competition
- anti-competitive commercial practices; and
- transactions in financial instruments, market standard master agreements, financial contracts, instruments and products.

In addition, the International Chamber's jurisdiction may also derive from a contractual clause by which the parties give jurisdiction to Paris Courts. CICAP also has jurisdiction to hear appeals challenging international arbitration awards. More generally, CICAP has jurisdiction over appeals from first-instance judgments entered by the International Chamber of the Commercial Court of Paris.

### **The International Chamber's procedure for examining cases**

#### *Composition of the International Chamber*

The CICAP is composed of three English-speaking judges (ten judges made up the International Chamber of the Paris Commercial Court), knowledgeable in Common Law, who will apply French, European Union, or applicable foreign law. In the event of a dispute requiring the expertise of judges from specialised chambers, judges from other chambers of the Court of Appeal may sit on the judgment panels of the Chamber.

#### *The consent of the Parties to proceed in accordance with the Protocol*

It is important to note that the application of the rules set forth in the Protocol is subject to the agreement of all the parties and this agreement has to be reached at the first hearing. As a result, if the parties do not agree to proceed in accordance with the procedures contained in the Protocol, the judge will nevertheless remain in charge of the case but will then apply the 'classic' rules of the Civil Procedure Code.

#### *Procedural timetable*

The objective of the International Chamber is to meet the expectations of the business community, as mentioned in the Preamble of the Protocol. It is essential to give to the parties a timetable that enables them to anticipate the duration of the proceedings, which is the reason why a supervising judge will set a procedural timetable that includes the date on which attorneys shall deliver their oral arguments together with the date of deliverance of the decision.

Emergency situations will also be taken into account by the International Chambers. Thus, depending on the circumstances, the judges may hear the parties within very tight time limits of two to three months after the beginning of the proceedings.

#### *The use of the English language*

One of the major procedural innovations of the International Chamber is the use of the English language. The use of a foreign language had to be reconciled with two major French law provisions, which provide that French is the official language in France.

On the one hand, the French Constitution establishes the principle that ‘The language of the Republic is French’ (Article 2, section of the Constitution). When this provision was interpreted by the Constitutional Council in the context of the Convention on the Grant of European Patents, it was decided that the Constitution did not preclude a court from accepting, in certain cases, the use of a foreign language if the parties and the court so agreed. This obstacle has thus been overcome.

On the other hand, the Ordinance (*Ordonnance*) of Villers-Cotterêts dated 25 August 1539 provides that procedural documents must be drawn up in French (the purpose of the ordinance being, at that time, to draw up documents in a language that could be understood by most people, which meant no longer drafting procedural acts in Latin). The Court of Cassation still applies these provisions as a reminder that they apply only to procedural documents and not to exhibits or testimonies which may be produced in a language other than French, if all the parties accept this and the judge understands the language and consents to its use. In practice, the main difficulty with filing exhibits in English may be the judge’s understanding of English when required to rule, a difficulty that will not arise before the International Chamber since the judges are completely fluent in English. This is why, under the Protocol, the use of English will be facilitated at all stages of the procedure:

- Documentary evidence may be produced in English without translation;
- Witnesses, experts and parties to be heard may speak in English;
- Non-French lawyers authorised to appear before the Court may use the English language to plead;
- Pleadings may be translated simultaneously with the agreement of the International Chamber;
- The judgment of the Court will be delivered in French together with a sworn English translation.

#### *Judicial administration of evidence – testimonial evidence*

Another characteristic of the International Chamber is the wider importance given to testimonial evidence. In this way, as it is a common rule before the Commercial Court of London, the examination of the parties, third parties, and experts may be ordered by

the supervising judge or by the Court, the person being possibly cross-examined by any of the parties.

This is a real change in the conduct of trials in France. While the hearing of the parties and witnesses was theoretically provided for in the Code of Civil Procedure (Articles 184 *et seq.* for the personal appearance of the parties; Articles 199 *et seq.* for third parties; Articles 245 and 283 for experts), it was only very rarely implemented, the written form being by far the preferred method. This is a very interesting innovation in the conducting of trials, since the Court and the parties will thus be able to confront the witnesses and experts on their potential contradictions. It also means that every precaution should be taken – even more than previously – before filing a written statement whose author may end up on stand.

#### Conclusion

The Protocol is henceforth in force and has applied to appeals lodged before the Paris Court of Appeal since 1 March 2018. This International Chamber is already dealing with several cases: the first oral hearings before the Court of Appeal are scheduled to be held in September 2018, just six months after the Chamber was created.

Paris, now more than ever, is a very attractive legal centre for disputes between international trade and finance players.

#### Notes

- 1 The author would like to express her gratitude to Gabriela Mihaescu for her assistance in the preparation of this article.
- 2 Regulation (EC) No 44/2001 of 22 December 2000, <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32001R0044&from=FR>.
- 3 Regulation (EC) No 1215/2012 of the European Parliament and of the Council of 12 December 2012, [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2012.351.01.0001.01.ENG&toc=OJ:L:2012:351:TOC](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2012.351.01.0001.01.ENG&toc=OJ:L:2012:351:TOC).
- 4 <http://www.paris-europplace.com/fr/la-place-financiere-de-paris>
- 5 *Préconisations sur la mise en place à Paris de Chambres spécialisées pour le traitement du contentieux international des affaires*, HCJP, [https://publications.banque-france.fr/sites/default/files/rapport\\_07\\_f.pdf](https://publications.banque-france.fr/sites/default/files/rapport_07_f.pdf).
- 6 As provided for in the Preamble of the Protocol.
- 7 See Preamble of the Protocol.
- 8 See the Decision n°2006-541 DC of 28 September 2006, <http://www.conseil-constitutionnel.fr/conseil-constitutionnel/francais/les-decisions/acces-par-date/decisions-depuis-1959/2006/2006-541-dc/decision-n-2006-541-dc-du-28-septembre-2006.999.html>.
- 9 Art. 11 of the Ordinance of Villers-Cotterêts.
- 10 Cass. Civ. 1<sup>ère</sup>, 22 September 2016, n°15-21176; Cass. Com., 27 November 2012, n°11-17185.

# Troubled waters in Spain on the concept of procedural public policy and the non-equivalence of court judgments and arbitral awards

**Roger Canals**

Arco, Barcelona and Madrid

rogercanals@arcoabogados.es

**A**rbitration in Spain has traditionally been founded on the principle of the inability to challenge before the State Courts the grounds and reasoning of the awards on the facts under discussion and on the applicable law. In addition, and as in most of countries, the concept of procedural public policy has been construed in Spain in an extremely narrow manner. It is traditionally reduced to the respect of the principles of equal treatment between the parties, the right of the parties to be heard, the right to refute other parties' petition (right of refutation) and the prevention of procedural fraud (the Spanish Arbitration Act, hereinafter 'SAA', does not distinguish between internal public policy and international public policy).

Nevertheless, over recent years, case law has been cast by several High Justice Courts, especially the one seated in Madrid, which stretched the concept of procedural public policy beyond its commonly accepted limits and annulled arbitral awards on the grounds of lack or insufficient reasoning, or by challenging the accuracy of the arbitrators' reasoning and/or application of law. Although these trends have not spread all countrywide and have, so far, been limited to the annulment of internal awards, they have created deep-seated unrest in the Spanish arbitral community. Madrid is the main seat for arbitration in Spain and it is widely accepted by professionals devoted to arbitration that, if such trends become the norm, then Spain would be set apart from mainstream international standards on arbitration.

This paper intends to discuss the origins of such new case law. It also aims to put in writing some thoughts regarding the limits

of procedural public policy as grounds for annulling arbitral awards and/or to prevent their enforcement in Spain by the State Courts.

## The case law produced by the High Court of Madrid on the annulment of arbitral awards for breach of procedural public policy

The case law analysed hereto, by which the traditional, narrow concept of public policy is suffering a significant enlargement, began within the context of the peak of the financial crisis that severely undermined Spain over the last decade. In such a context, the High Court of Justice of Madrid (HCJM) cast several judgments where it perhaps (and to my view, wrongly) aimed to provide material justice (by redressing theoretical inequality between contractual parties). It annulled several arbitral awards in cases on toxic financial products sold by banks and/or financial institutions to minor investors. In such resolutions, the HCJM both challenged the properness of the application of substantive law performed by the arbitrators, and either the accuracy, or correctness, of the arbitrators' reasoning.

Far from being halted, this case law trend of expanding the borders of Spanish public policy carried on with subsequent judgments, as those cast by the HCJM on 8 January 2018 and on 5 April 2018. Such recent judgments deepened the trend of enlarging the procedural public policy limits, as: 1. court decisions rest exclusively on the violation by the annulled awards of procedural public policy, and 2. there was not, within the cases at stake, any trace of inequality or abuse of substantial law between the parties 'inviting' the Court to (wrongly) opt for material justice.

In its judgment rendered on 8 January 2018, the HCJM annulled an award which had decided on a controversy between two family-owned groups, regarding the winding-up of a company, on the grounds of an alleged breach of procedural public policy. It considered the reasoning of the arbitrators to be improper, as several court resolutions with collateral influence on facts under discussion within the arbitration procedure were not taken into account in the award reasoning. Thus, the HCJM considered that it had the ability to review the award reasoning and to annul the award on the basis that its underlying reasoning was insufficient or improper.

In its judgment rendered on 5 April 2018, the HCJM annulled an award in a case where the litigation related to the construction of a wind farm, by challenging the assessment made by the arbitrators on the importance granted to certain pieces of evidence to the detriment of others (the arbitrators based their decision on statements made in several emails and set aside other evidence). The HCJM considered the reasoning by which arbitrators reached their conclusions to be inappropriate, since the arbitrators did not consider certain pieces of evidence regarded as relevant by the court. The judgment therefore ordered the annulment of the award. Thus, in this type of resolution, the HCJM not only concluded that the reasoning of the arbitrators was part of the Spanish procedural public policy, but considered that the State Courts were even allowed to review the adequateness and properness of the assessment the arbitrators made with regards to the evidence on which they founded their awards.

### **The origins of the new case law trend; amendment of the Spanish Arbitration Act and the concept of equivalence between court judgment and arbitral awards.**

There is a dual common rationale behind the case law referred to in the first section of this article. Firstly, there is the lack and/or insufficient reasoning of an arbitral award as a breach of Spanish procedural public policy and, secondly, there is the equating of the standards in terms of the reasoning for an arbitral award and for a judgment rendered by state courts. The latter occurs by applying a misled and biased interpretation of the concept of

‘jurisdictional equivalent’ – a concept created by the Spanish Constitutional Court (‘SCC’) to underline the same effects from a *res judicata* perspective of an arbitral award and a Court judgment).

The inclusion of the compulsory reasoning of arbitral awards as part of Spanish procedural public policy finds its roots in the amendment of Article 37.4 of the SAA that came into force in May 2011, by which, in broad terms, the lawmaker eliminates the possibility of agreement between the parties that an arbitration could be decided by a non-reasoned award. This therefore requires that arbitral awards rendered in Spain be reasoned in any case. This amendment is not in line with the dominant trend of international arbitration. Many arbitration laws accept non-reasoned awards (insofar as the parties have agreed) as valid and enforceable (as, for example, in Article 52.4 of the English Arbitration Act of 1996; Article 1054.2 of the German Arbitration Act of 1998; Article 38.1 of the Japanese Arbitration Act; Article 42.3 of the Portuguese Arbitration Act of 2011; Article 1057.5 of the Dutch Civil Procedure Code and Article 1244.8 of the Luxembourgian Civil Procedure Code).

With such an amendment of SAA in 2011, the HCJM and some other scattered courts consider that the level of reasoning that an arbitral award must contain has to be equivalent to the standard requested for State Court judgments. This applies the concept of the ‘jurisdictional equivalent’ to arbitration. This concept was conceived by the SCC to grant the same effects of *res judicata* to arbitral awards and to State Court judgments. However, the *clef de voûte* of the issue lies with the fact that the SCC never stated that awards and judgments were of the same nature and thus both had to abide by the same standards in terms of reasoning. It is thus through a misled interpretation of the concept of the ‘jurisdictional equivalent’ that the HCJM has annulled awards on the grounds of insufficient reasoning as they did not meet the reasoning requirements requested by a court judgment.

Therefore, and although this may seem an obvious matter from an international perspective, the essential issue at stake is whether, in Spain, the validity and enforceability of arbitral awards require the same standards of reasoning as court judgments on the basis of Spanish procedural public policy.

Several significant professional voices have already pointed out that state courts should come back to the traditional, narrowly-construed concept of procedural public policy, refraining from reviewing and refuting awards' reasoning to void them and/or to prevent them from being enforced. The judgment rendered by the Spanish Constitutional Court on 11 January 2018, included a dissenting vote from three judges who did not endorse the concept of the 'jurisdictional equivalent' insofar as such a concept entails the same reasoning requirements for an arbitral award that those required for State Court judgments.

### Conclusions

Although almost exclusively focused in Madrid and, so far, restricted to the annulment of domestic awards, the case-law trend initiated by the HCJM, which expands the concept of procedural public policy, is in line neither with international standards on arbitration, nor with the Spanish lawmaker's intention to promote arbitration as an alternative to dispute resolution and

discharge collapsed State Courts. To tackle this trend, which sets Spain apart from the mainstream of international arbitration standards on the interpretation of procedural public policy, it would be highly advisable to undo the amendment introduced in 2011 on Article 37.4 of the SAA (thus recovering the possibility for the parties to agree on a non-reasoned award), and to revert to the traditional, narrowly-construed concept of procedural public policy, according to which an improperly and/or inaccurately reasoned arbitral award does not breach Spanish procedural public policy.

### Notes

- 1 Ley 60/2003, de 23 de diciembre, de Arbitraje.
- 2 Sala de lo Civil y de lo Penal, Sección Primera, del Tribunal Superior de Justicia de Madrid.
- 3 Judgments rendered by the High Court of Madrid (Sala de lo Civil y de lo Penal, Sección 1ª, del Tribunal Superior de Justicia de Madrid) on 28 January 2015, 14 April 2015, 23 October 2015 and 17 November 2015.
- 4 In its initial wording, Article 37.4 of the SAA allowed the parties to agree on a non-reasoned award. Such a possibility was eliminated by the new wording of that article introduced by the Act 11/2011, of 20 May 2011.
- 5 See the judgment rendered by the High Court of Justice of Asturias 3/2017.

## Italian judges recognise the Russian roulette clause

The Court of Rome<sup>1</sup> assessed, for the first time, the lawfulness of the Russian roulette clause under Italian law.

### The Russian roulette clause

Unlike common law countries, the Italian legal system is a closed legal system where typical contracts (expressly regulated by the law) and atypical contracts (not expressly regulated by the law) coexist.

The Russian roulette clause is an atypical clause that parties may wish to include (for example, in a shareholders' agreement or in the bylaws of a company) to resolve any deadlock situations in a company's decision-making process or as a result of the non-renewal of expired shareholders' agreements ('triggering events').

Due to its atypical nature, and in order to be valid under Italian law, such a clause should be justified by an interest worthy of protection. According to Italian law, deadlock situations causing the paralysis of a company may lead to that company's dissolution and liquidation. Italian judges have thus recognised that resolving deadlock situations through a contractual mechanism, in order to safeguard the business and avoid the costly and time-consuming liquidation of the company, has to be considered an interest worthy of protection under Italian law.

In case of inactivity of the decision-making bodies due to the existence of equal and opposing voting rights, the Russian roulette clause allows for termination of the corporate relationship by forcing the exit of one of the

### Maurizio Vasciminni

Pavia e Ansaldo Studio Legale, Rome  
maurizio.vasciminni@pavia-ansaldo.it

### Giada Russo

Pavia e Ansaldo Studio Legale, Rome  
giada.russo@pavia-ansaldo.it

### Giovanni Gigliotti

Pavia e Ansaldo Studio Legale, Rome  
giovanni.gigliotti@pavia-ansaldo.it

two shareholders and the acquisition of the entire share capital by the other.

More specifically, the parties can agree that, upon the occurrence of the triggering event, one of the two shareholders can carry out an economic assessment of the entire share capital and offer to buy the shares of the other shareholder or to sell its own shares to the other party at the same price.

The shareholder who receives the offer is free to choose whether to proceed with this sale or to purchase the shares held by the first-offering shareholder at the price set exclusively by the latter.

Although the offering party is not required to justify the price offered or to disclose the criteria used to carry out the assessment, Italian judges have pointed out that the essence of the mechanism of the Russian roulette clause prevents the offering party from carrying out an unfair evaluation of the sale price.

The dual faculty of the shareholder who receives the offer to sell or buy the shares of the offering party ensures bargaining equilibrium, since the shareholder who set the price and offered to buy the shares of the other party faces the risk of selling its own shares under the same condition.

However, according to Italian judges, the Russian roulette mechanism does not completely neutralise the risk of abuse of the clause. For instance, one shareholder might even provoke a deadlock situation and then offer to purchase the other shareholder's shares at a low price knowing that the other party cannot 'afford' to purchase the offering party's shares anyway.

Therefore, for the purpose of the validity of the Russian roulette clause, the evaluation of the sale/purchase price must not be determined in a totally arbitrary manner or have an expropriation effect. As the Court of Rome emphasised, Italian law allows the party to determine the content of the contract, but such a determination must not be an arbitrary decision by one of the parties.

### **Similarities and differences between the Russian roulette clause, the drag along clauses and put and call options**

The Russian roulette clause shares similarities with some clauses that regulate the transfer of shares: drag along clauses and put and call options.

In a drag along clause, one of the shareholders acquires the right to negotiate

with the sale of the entire share capital, including the shares of the other shareholders, with third parties. The selling shareholder then drags the others in the transfer.

A drag along clause can have effects similar to those of the Russian roulette clause when the 'dragged' shareholder has a pre-emption right on the shares of the selling shareholder. In such cases, the 'dragged' shareholder may alternatively buy the other party's shares or sell its own shares to the third party at the same price.

Through a put option, a shareholder undertakes the obligation to sell a certain amount of its shares at a predetermined or determinable price; the call option grants a shareholder the right to purchase a certain amount of shares at a predetermined or determinable price.

As through the use of a Russian roulette clause or a drag along clause, the parties may use put or call options to break deadlocks by forcing the exit of one or another shareholder.

However, it is important to emphasise that there are considerable differences between the peculiar characteristics of the Russian roulette clause and the other aforementioned clauses.

Unlike drag along clauses, in order to be valid the Russian roulette clause does not require the existence of any predetermined criteria for the evaluation of share capital, nor the respect of the principle of fair evaluation of the divested shares. However, in no event may the party exercising the Russian roulette clause use its right to expropriate the other shareholder.

Furthermore, while there are doubts about the possibility of including put and call options in anticipation of the non-renewal of a shareholders' agreement, the Russian roulette clause is expressly recognised as an instrument aimed at solving deadlocks resulting from the non-renewal of a shareholders' agreement.

### **Final considerations**

In light of the above and given its atypical nature, recognition of the Russian roulette clause in the Italian legal system is particularly important.

This clause is a very flexible instrument which best satisfies the will of the parties when regulating their corporate relationships.

Moreover, as highlighted above, the Russian roulette clause allows some of the limitations that characterise drag along clauses and put

and call options to be overcome. It makes it possible to resolve a company deadlock due to an impasse in decision-making or non-renewal of an expired shareholders' agreement.

The recognition of clauses of this type show the Italian courts' growing trend of granting parties more freedom to regulate their own interests in an atypical way, even in a closed legal system.

However, as pointed out by Italian judges, the validity of the interests protected by the Russian roulette clause does not automatically imply its lawfulness.

The Court of Rome has recalled that the duty of good faith, and therefore the behaviour of the parties in regulating their affairs, shall be considered the main criterion through which the validity of a Russian roulette clause should be assessed.

#### Notes

- 1 Judgment no. 19708 of 19 October 2017.
- 2 According to Italian Civil Code, at least the value due to the shareholder in case of withdrawal, to be determined taking into account the company's equity, its expected incomes and the market value of the shares.

## Punitive damages in Italy

**T**he Italian civil liability system (like most civil law systems) is typically compensatory, in that it only redresses the consequences of the damage suffered by the victim, either by paying a sum of money or by reinstating the *status quo ante* (eg, the situation that existed before the damage occurred). This redress is strictly proportional to, and cannot exceed, the extent of the damage suffered by the injured party.

However, punitive damages, as applicable in certain common law systems, go beyond, and are not proportional to, that which is necessary to compensate the victim for the damage suffered, the purpose being one of punishment and deterrence. Such damages are awarded in addition to compensatory remedies in such a way as to punish the perpetrator of an illicit conduct for his reprehensible behaviour (punitive function) and deter both him and the community at large from committing similar acts in future (deterrent function).

Until now, according to the interpretation provided by Italian case law, the concept of punishment and sanction has never really been a part of the Italian legal system. To be precise, the Italian courts have usually excluded the possibility of imposing punitive damages, above all in the context of the recognition and execution of foreign decisions providing for the application of such punitive damages, which until now have been considered in contrast with so-called Italian public order (*ordine pubblico*).

However, in recent years, the Italian legislator has introduced a number of provisions, which – though not formally considered punitive damages – have a clearly punitive effect, going beyond the mere compensation for the damage suffered, or loss incurred, by the victim. We refer, specifically and without limitation, to:

- Article 96, paragraph 3, of the Italian Code of Civil Procedure, which grants the judge the power to condemn – at his own discretion – the losing party to pay the successful party a sum determined according to equity, for misusing the civil process. In this case, there is no need to prove that the losing party actually caused any damage to the successful party: the mere fact that the losing party has been deemed to act in bad faith is sufficient to condemn him to pay the aforementioned sum.
- Article 614-*bis* of the Italian Code of Civil Procedure, which empowers the judge to impose the payment of a pecuniary fine for breaches or delays in enforcing judicial decisions that condemn the party to act or refrain from acting, without any specific references to any losses there may have been.
- Legislative Decree no. 7 of 15 January 2016, which decriminalises certain offences, such as libel and defamation, providing fines for such acts, in addition to any compensation due for the damage suffered by the injured party.

### Daniele Geronzi

Legance, Rome and Milan

dgeronzi@legance.it

### Stefano Parlatore

Legance, Rome and Milan

sparlatore@legance.it

### Giorgio Colombo

Legance, Milan

gcolombo@legance.it

Also in light of said legislative innovations, under judgment no. 16601/2017, passed on 7 February 2017, and published on 5 July 2017 (the ‘Judgment’),<sup>1</sup> the Italian Supreme Court (*Corte di Cassazione*) – which leads the Italian judicial system – has, for the very first time, reconsidered the function of the Italian civil liability system, by establishing that punitive damages are not necessarily inconsistent with the typical compensatory purpose of civil liability. It has also established that foreign decisions applying punitive damages may – on certain conditions – be recognised and enforced in Italy.

Specifically, the case decided by the Italian Supreme Court in the Judgment concerned the request by a US distributor to recognise and enforce in Italy a final US decision condemning an Italian supplier to pay, *inter alia*, punitive damages. The Italian supplier challenged the request of the US distributor, maintaining that punitive damages are totally inconsistent with the Italian civil liability system, the sole function of which is to compensate damage actually suffered by the victim. Moreover, the Italian supplier claimed that punitive damages are not proportional to that which is necessary to compensate the injured party for the damage suffered, and are therefore in breach of Italian public order.

The Italian Supreme Court carried out an in-depth analysis of Italian public order, which – as mentioned – represented the traditional limit on the recognition and execution of foreign decisions applying punitive damages. Specifically, the Italian Supreme Court found that Italian public order is to be interpreted in accordance with ‘international public order’ (*ordine pubblico internazionale*) and in a wider, supranational perspective, thereby ensuring the broadest protection of individual rights. Italian public order must encompass the entire spectrum of fundamental rights and freedoms recognised by domestic legislation over a certain historical period,

as well as those generally protected by the international community as a whole.

On this basis, the Italian Supreme Court concluded that the Italian civil liability system can perform different functions. Firstly, it grants compensation to the injured party, restoring the consequences of the damage suffered by the victim. Secondly, civil liability ensures the punishment of the person held liable for illicit conduct and deters the tortfeasor and the community in general from committing similar acts in the future. Consequently, foreign decisions applying punitive damages do not automatically breach Italian public order (*ordine pubblico*), and are thus recognisable and enforceable in Italy, but subject to two fundamental conditions:

- such foreign decisions must come within a legal system in which punitive damages are provided by the law, and are thus contemplated and regulated in such a way that the tortfeasor’s procedural and substantial defence rights are not jeopardised;
- the amount of punitive damages must take into account the extent of the damage actually suffered by the victim and any compensation granted to him, averting the risk of the tortfeasor being condemned to pay an excessive and disproportionate fine.

Ultimately, the judgment of the Italian Supreme Court may prove to be a veritable revolution in the Italian legal system, superseding the previous orientation and acknowledging the multifunctional nature of the civil liability system, comprising the functions of punishment and deterrence. We now await the practical application by Italian lower courts of the innovative principles described above, in recognising and enforcing foreign decisions ordering the payment of punitive damages.

#### Note

- <sup>1</sup> The judgment is published on *Rivista di Diritto Industriale* 2018, 2, II, 226.

# Concordat in light of recent amendments to the Turkish Code of Enforcement and Bankruptcy

**Ozlem Cavus Gercek**

Pekin & Bayar, Istanbul

**Tugce Asli Turcal Cakmak**

Pekin & Bayar, Istanbul

t.turcal@pekin.com.tr

**W**ithin the scope of the state of emergency (SoE) in Turkey, certain amendments to the laws were made with State of Emergency Decrees. As per the SoE Decree No. 669, published in the Official Gazette dated 31 July 2016, it has become prohibited for companies to apply for bankruptcy protection during the SoE term. The relevant procedure was observed to be frequently used, and sometimes abused, by companies in financial difficulty, in order to avoid bankruptcy.

Later, the Law No. 7101 on Amendments to the Turkish Code of Enforcement and Bankruptcy (CEB) and Various Laws ('Law No. 7101') was published in the Official Gazette dated 15 March 2018 with No. 30361, where the institution of bankruptcy protection was completely abolished. The relevant amendment affected both the CEB and Turkish Commercial Code (TCC). In parallel to this change, a detailed amendment was made to the 'concordat' proceeding, governed under the CEB.

## Purpose of amendment

It should firstly be stated that concordat is not completely new to the CEB: it had been existent in the CEB but was rarely being used. By way of the new amendments and detailed regulations to the concordat proceeding, the aim has been to actively include the creditors to the process, where companies in financial difficulty strive for financial recovery and to avoid bankruptcy. With the new amendments to the law, concordat provides a higher level of opportunity to the creditors to present their opinions and objections during the proceedings, compared with revoking bankruptcy protection rules.

## Competent court

One of the first significant amendments is that the competent court to hear the concordat lawsuits has been changed. While the competent courts were previously the execution courts, the new law provides that the courts competent to hear the concordat lawsuits are commercial courts.

## Opportunity to pay in deferred term and/or having a discount on debts

The second important amendment is that, the requirements of 'being a merchant' and 'being indebted' for being able to resort to concordat have been abolished. By this amendment, every (natural or legal) person who is not able to pay their matured debts or risks of defaulting on payment may apply to the commercial court and request concordat, so that the debtor may be granted a deferred term and/or a discount for payment of their debts. Within this scope, the debtors shall submit the relevant documents presenting: 1. their debts; 2. in what term and/or ratio they will make payments; 3. how they will provide relevant financial resources to continue their operations and to make payments to the creditors; and 4. their assets as of the date of application to the court.

## Difference of temporary term and definite term

The amendment provides a separation of temporary term and definite term. Within this scope, if the court has a positive impression following the review of documents and project to be submitted by the debtor, the court will firstly grant a temporary term of three months to the debtor. This term may be extended for up to two additional months. In addition, the court will also appoint a

temporary concordat commissaire, in order to closely inspect whether it is possible for the concordat to be successful.

During this term, the creditors of the debtor may also submit their opinions and/or objections to the concordat project. In addition, at the end of the temporary term, the concordat commissaire will prepare a report regarding the process. In light of the debtors' and the creditors' submissions, as well as the commissaire report, the court will declare its decision regarding the definite term. The definite term is the one-year term to be granted to the debtor by the court, provided that the court is convinced there is a chance for the concordat to be successful. This definite term may be extended up to six additional months.

### Board of creditors

Another novelty provided by the amendment is that it is now possible to establish a board of creditors in order to ensure the active involvement of the creditors in the process. On the conditions that the board shall not exceed seven creditors, shall consist of an uneven number of creditors and shall not be granted any fee, the court may allow establishment of a board of creditors.

The board of creditors will supervise the activities of the commissaire, may provide advice to the commissaire and may also express opinions to the court, if needed. The board of creditors allows the creditors, whose receivables differ in terms of their legal basis from the receivables secured by collateral, to be represented fairly. The board of creditors will gather at least once a month and the decisions will be taken with a simple majority of the attendants.

### Effects of terms with respect to the creditors

Within the concordat term (as of the announcement of temporary term), no execution proceeding (except for the receivables secured by collateral) may be initiated against the debtor; the previously initiated execution proceedings shall be suspended; the interim injunctions or provisional attachments shall not be granted; interests do not accrue; the execution proceedings for the receivables secured by collateral may be initiated and the previously-initiated proceedings may be continued. However, no confiscation can be applied and the collateral cannot be sold. The debtor may

terminate the contracts which prevent the concordat from being successful, provided that the commissaire considers it appropriate and the court approves it. The other contracts to which the debtor is a party will continue to be executed.

With respect to the contracts where the debtor is a party and where the relevant contracts have an important role for the continuation of operations, the provisions governing that 'the debtor's resorting to concordat would be a breach of contract' or that 'it would constitute grounds for rightful termination' or that 'the debt would be considered as matured' shall not be applied. Within this scope, whether or not the counter party to the contract is affected from the concordat project will not be taken into consideration, either.

### Effects of terms with respect to the debtor

Following the decision for a temporary and definitive period, the debtor may only continue its operation under the supervision of the commissaire. Unless otherwise allowed by the court, the debtor shall not establish pledge, provide surety, transfer the immovable and the permanent equipment of the business, or engage in gratuitous transactions. Otherwise, the transactions will be deemed null and void. In the event of debtor's breach, the court may suspend the debtor's power of disposition on the assets, or it may reject the request for concordat.

### Creditors' meeting

The commissaire to be appointed by the court will prepare a report presenting the receivables, debts and the assets of the debtor and their values. Subsequently, the commissaire will invite, with an announcement, all the creditors to notify their receivables. The creditors may notify their receivables within fifteen days as of the announcement. Creditors who have not notified their receivables within 15 days of the announcement shall not be allowed to participate in the negotiations of concordat project, unless their receivables are registered in the balance sheet of the applicant for concordat.

After the relevant term, the commissaire will make another announcement and invite the creditors for a meeting to negotiate on the concordat project.

### The conditions for approval of concordat project

In order for the project to be deemed accepted by the creditors, it shall be accepted by:

- the simple majority of the existing creditors and their receivables; or
- more than one quarter of the total number of creditors and two-thirds of their receivables.

### Affirmation of concordat and its consequences

In order for the debtor to be able to start payment within the scope of a concordat project, the agreement must be affirmed by the court. Upon the court's decision on the affirmation of the concordat, the provisions of concordat will be binding on all creditors, notwithstanding their acceptance or rejection of it.

The court's affirmation decision may be granted only if:

- the amount suggested in concordat is understood to be more than the amount which the creditors may receive in case of the debtor's bankruptcy;
- the suggested amount is proportional to the debtor's resources;
- the concordat project is accepted by the majority of the creditors and the receivables mentioned above;
- the legal fees required for affirmation of the concordat are paid by the debtor.

In order to ensure confirmation with the affirmed concordat, a trustee may be appointed. The trustee shall submit a report to the court in every two months; the creditors may review the reports.

Following the court's decision on affirmation and the concordat's binding effect on the parties, all attachments (except for the attachments secured by collateral), which have been initiated before the temporary term decision and not yet liquidated, shall become null and void.

If the concordat is not affirmed by the court, the court will reject the request for concordat. In this case, if the debtor is a person who is subject to bankruptcy, the court will *ex officio* decide the bankruptcy of the debtor.

### Legal remedies

Once the court renders its decision regarding concordat request; the debtor or the creditors who requested the concordat may request appellate review before the Court of Second Instance, within ten days of the receipt of decision. Other creditors may request appellate review before the Court of Second Instance, within ten days as of the announcement of the decision. The decision of the Court of Second Instance may also be appealed before the Supreme Court of Appeal, within 10 days of the receipt of decision.

It should be stated that each creditor who has not been paid within the scope of concordat project may apply to the court and request termination of the concordat on their own behalf. In addition, each creditor may also apply to the court and request the termination of concordat in the event that the debtor breaches the concordat with its malicious acts.

### Conclusion

In brief, concordat may be defined as an agreement to be concluded between the debtor and the creditors, in compliance with the consent of the majority, and to be entered into force upon the court's affirmation (unless the finalisation of the court decision is not specifically required in the concordat project).

The latest amendment made to the CEB aims at the maximum attendance of the creditors throughout the project.

It is required that the project be concluded within a given term, which may be estimated as two and a half years (five months – three and two months – for temporary term, one and a half years for definite term, and six months for affirmation of the concordat).

In the event that the concordat process is successfully carried out, the creditors will have the opportunity to receive their receivables in instalments and/or with discount. Otherwise, the debtor will be declared bankrupt.

**Julia Kurylo**

SKG, Kiev

j.kurilo@skg.org.ua

# Ukraine: commercial arbitration changes in 2018

The ongoing reform of the Ukrainian judiciary has caused the Parliament to revise procedural rules in the sphere of dispute resolution. At the end of 2017, therefore, the Verkhovna Rada adopted Law No 2147-VII On Amendments to the Commercial Procedural Code of Ukraine, the Civil Procedural Code of Ukraine, and other legislative acts.

Keeping in sight the restoring of trust in the judiciary within Ukrainian society as the main objective of the reform, the amendments to the civil and commercial procedural rules aimed at adapting the judiciary to the digital era, as well as boosting its efficiency, by introducing new procedural institution, eliminating unnecessary stages, excluding abuse of procedural rights as well as facilitating alternative dispute resolution means.

International commercial arbitration 'has become so widespread that it is a primary method for dispute resolution of transnational contract'. The same trend has been upheld in Ukraine through the reform of the judiciary. The new codes of procedure (both civil and commercial) are definitely crafted to fill in procedural gaps, which had been restricting local progress in this global trend.

The first and the most important change to the Commercial Procedural Code of Ukraine sets forth legal grounds supporting a pro-arbitration approach in the assessment of the validity and enforceability of arbitration clauses or agreements. Courts are now required by law to interpret any discrepancy/inaccuracy in the wording of an arbitration clause/agreement in favour of its validity and enforceability.

Under the new regulation, parties to an international commercial arbitration and the arbitral tribunal itself have at their disposal tools to support arbitration procedure. For example, the relevant competent court may order to provide, inspect and preserve evidence upon written request to a party to the arbitration or the arbitration tribunal.

Another valuable addition to the Code of Civil Procedure eliminates doubts as to the availability of interim measures in the course of an arbitration. To grant interim measures,

the court is to be satisfied that a request for arbitration or an equivalent document commencing arbitration is filed in due course and that there is a valid arbitration clause/agreement between the parties. There's also a provision enabling the defendant/any other party involved in the matter to be compensated for the damage caused by the interim measures, should the initial claim be rejected in full or in part by the arbitral tribunal.

Procedural rules for setting aside an arbitral award, should the arbitration proceeding take place in Ukraine, have been finally set forth in the new edition of the Civil Procedural Code of Ukraine. The regulation determines, among others things, the time bar for the claim, and also enables not only parties to the arbitration to apply for setting aside the award but also third parties, claiming that the arbitral award is affecting their legal interests. Additionally, until the claim for the setting aside of an arbitral award is resolved by the court, enforcement proceeding is available. Both claims are to be heard simultaneously, which excludes parallel proceedings and probable ambivalence in the assessment of the same facts, grounds for setting aside or denial for the enforcement of this very arbitral award. In addition, Ukrainian civil procedure law now allows the parties to challenge an award on the arbitral tribunal's jurisdiction immediately, in case this procedural issue has been resolved by the arbitrators separately.

Another addition included in the Commercial Procedural Code should be mentioned. The Commercial Court should now decline jurisdiction without prejudice as to the merits of the case, should it establish that there is a valid arbitration clause binding on the parties. It means that if the arbitral tribunal consequently denies jurisdiction, the claimant still has the right to refer its claim to the Ukrainian courts. However, if the parties conclude an arbitration agreement in the course of the ongoing litigation proceeding, the court should put an end to the proceeding and a subsequent application will not be allowed.

Provisions for the enforcement of arbitral awards underwent cosmetic modifications. Among them, it is worth mentioning the exclusive jurisdiction of the Kyiv court of Appeal over any enforcement proceeding related to an arbitral award issued outside of Ukraine. Courts enforcing arbitral awards may, according to the new regulation, grant post-arbitral interest, which is to be established by the Enforcing body at the moment of actual recovery of the funds.

In terms of digitisation, the amendments to the Law on International Commercial Arbitration establish that an arbitration agreement can be entered into electronically, provided that the content of such a clause/agreement is fixed and accessible for future reference.

Courts decisions on claims to set aside an award or to enforce an award (whether

granting of refusing the setting aside or the enforcement) are subject to appeal. However the new procedural rules have reduced the appeal options to one round.

### Conclusion

By reducing uncertainty in relation to international commercial arbitration through removing considerable procedural gaps in the law, the judiciary reform aims at providing a reliable, clear and straightforward legal framework and encouraging the judiciary to play its part in favour of a deeper inclusion of the Ukrainian economy into the global trade.

### Note

<sup>1</sup> Margaret Pedrick Sullivan, 'The Scope of Modern Arbitral Awards', 62 Tul L Rev 1113, 1122 (1988).

## MIDDLE EAST

# Saudi Arabia: companies law amendments may increase shareholder derivative litigation

**Jonathan Burns**

Dentons, Riyadh  
jonathan.burns@  
dentons.com

**A**mendments to Saudi Arabia's Companies Law, which came into effect in April 2018, seemingly return a rudimentary concept of standing for shareholder derivative claims to the statute, while introducing a new concept of cost-shifting for such claims. This may have the effect of incentivising shareholder litigation practice in Saudi Arabia. Joint stock companies incorporated in Saudi Arabia should ensure that adequate internal policies are in place, in order to confront a potential increase in such claims.

### Introduction

Shareholder derivative claims are generally uncommon and Saudi courts have largely followed the American Rule on litigation costs, whereby litigating parties all bear their

own costs (absent a statutory or contractual basis otherwise), as opposed to the English Rule, whereby the losing party bears the prevailing party's costs.

However, the basis for this standard in Saudi Arabia does not stem from common law theories but from Islamic law (*Shari'a*) financial principles forbidding unjust enrichment and speculation. Put differently, Saudi judges, trained in *Shari'a*, generally only award actual, proven damages to the prevailing party. Based in part on the general straightforward attitude of the judiciary towards claims and legal professionals, attorneys fees are not generally considered to be within the ambit of actual damages because the aid of legal counsel is not considered to be a necessity. This also means that large payoffs, punitive damages, statutory treble damages and the like are generally unavailable in Saudi Arabia.

While the lack of cost-shifting in lawsuits, as well as *Shari'a* financial principles necessarily prohibiting large payoffs in judgments, has allowed Saudi Arabia to remain as a generally non-litigious society, the growth of the Kingdom has resulted in higher stakes and an increased need for a greater number of active legal professionals and judiciary.

### The Companies Law

In this regard, Saudi Arabia's legislators have, in recent years, been on an active and intense campaign to solidify the Kingdom's corporate governance culture, including cracking down on corruption, incompetence, nepotism and self-dealing in both the boardroom and the C-Suite.

In particular, legislators adopted a new Companies Law, which came into effect on 2 May 2016 (the 'Companies Law') abrogating and replacing the then-existing Regulations for Companies enacted in 1965 (the 'Regulations for Companies'). A large part of the new Companies Law was aimed at clarifying and strengthening corporate governance rules for companies in Saudi Arabia in an effort to place more accountability on officers and directors, while putting more power in the hands of shareholders.

Continuing in this goal, legislators enacted eleven amendments to the Companies Law on 10 April 2018 (the 'Amendments'). One such amendment seeks to return shareholder derivative claims to the statute, while introducing a new statutory basis for shifting attorneys fees in such claims, which is a largely novel concept in Saudi law.

### Re-introducing shareholder derivative claims

The Regulations for Companies (1965) originally provided a rudimentary framework for shareholder derivative claims under Article 78, whereby shareholders were given standing to sue the directors on behalf of the company for their wrongful acts, so long as the company's cause of action against the directors continued to exist and only if a demand/notice was first served on the company. However, shareholders taking on this burden could only recover the actual damage sustained due to the directors' acts.

Similarly, the new Companies Law provides for certain causes of action against the board of directors for their wrongful acts. In particular, under Article 79 the company may sue the directors for their wrongful acts causing harm

to all shareholders, whereas under Article 80 an individual shareholder may sue the directors for their wrongful acts causing harm to the individual shareholder itself.

In the former case, the decision to sue the directors must be taken by the shareholders at an ordinary meeting. However, the Companies Law does not describe in particularity the consequences or fallback options in the event that the shareholders fail to resolve to sue the directors at an ordinary meeting.

In that regard, the Amendments include a new provision that seemingly addresses this missing fallback option by re-introducing another rudimentary concept of shareholder derivative claims and including cost shifting, whereby a shareholder may shift derivative litigation costs to the company in this instance.

Some would argue that Article 80 of the new Companies Law has the same net effect, in that individual shareholders still have standing to sue, but under Article 80 shareholders are suing on their own behalf and will not be able to take advantage of statutory cost shifting in this case.

### Moving towards the English Rule in shareholder derivative claims?

The Amendment is vaguely drafted with an unclear reference to the fact that the shareholder may only shift its litigation costs to the company if the claim is 'in the interests of the company pursuant to Article 79', which implies that cost-shifting in this instance is only enforceable in shareholder derivative claims particularly, where all shareholders were harmed by the wrongful act of the directors *and* a resolution by the shareholders to sue the directors at an ordinary meeting was not obtained for some reason.

In addition to the constraints of passing the Article 79 hurdles, a shareholder may only shift its costs of bringing a claim against the company if: 1. the company fails to respond within 30 days to a complaint from the shareholder describing the reasons for the claim; and 2. the claim is made in good faith and on sound legal grounds.

### Conclusion

The codification of another cause of action and standing for shareholders to sue the directors on behalf of the company reflects the Kingdom's drive towards creating a more robust, shareholder-friendly corporate governance environment in Saudi Arabia.

This may have the effect of encouraging more claims by shareholders and their lawyers – who may be more disposed to file a claim on the basis that the company may be required to bear the cost of doing so according to statute.

However, the application of this provision is difficult to foresee in practice. The hurdles that must be overcome in order for the company to be required to bear a shareholder's costs are numerous, vague and difficult. Assuming the implication of Article 79 is correct, the cases in which cost-shifting may be required will be rare. Furthermore, if the shareholders did not approve a claim against the directors at an ordinary meeting, it may be difficult to convince the court that the claim against the company is indeed in good faith and on sound legal grounds, which is an additional hurdle to overcome. Even so, based on a plain reading of the Amendment,

the company can avoid liability for a shareholder-plaintiff's derivative litigation costs by simply replying to the shareholder-plaintiff's initial complaint within 30 days.

The Amendment does not specify the nature of the reply required. However, joint stock companies in Saudi Arabia should ensure that their internal corporate governance manuals and policies for officers and directors are clear and updated to ensure an appropriate response to shareholder complaints in line with the Amendments.

#### Note

- <sup>1</sup> However, note that Saudi courts will not enforce shifting of attorneys fees even if agreed in contract – based on *Shari'a* principles favoring only actual damages. Additionally, Saudi judges do have discretion to ignore statutory law if it is deemed contradictory to *Shari'a* in any way – and thus even a statutory mechanism for shifting attorneys fees may be subject to scrutiny under the *Shari'a*.

## Claims against foreign corporations in Israel

### Ronen Adini

Ronen Adini & Co,  
Bnei Brak

ronen@ronenadini.co.il

In recent years, Israeli courts have been required several times to address the question of their authority in order to hear claims in Israel against foreign corporations operating in Israel.

In this context, the issue is raised of whether Israel is the Forum Convenient, or whether Israel is not the adequate and appropriate forum to manage litigation proceedings against a foreign defendant ('Forum Non Convenient'). In this context, the question under examination is whether a court in Israel is the Natural Forum for litigation, or whether it is more appropriate to conduct proceedings before a foreign court.<sup>1</sup>

In examining the 'naturalness' of the forum, courts are required to consider the relevant ties between the law suit and the circumstances of the case, and the territory in question (Israel).<sup>2</sup>

As will be presented below, Adjudication of the courts in Israel is not uniform in this context, and the answer to this question depends on the circumstances of each particular case, although it is certainly possible to point to a growing trend of

recognition of Israel's jurisdiction in claims filed in Israel against foreign corporations operating in Israel.

The Supreme Court discussed the 'rule of majority of ties', which examines the question of what the majority of ties is that may bind the parties to the Forum Convenient for the action, for example: the seat of the parties; the place where they conduct business; the location of the relevant event(s); the subject-matter of the action; the location of the witnesses called to testify, etc.<sup>3</sup>

In a claim filed against LinkedIn Corporation ('LinkedIn'), the District Court held that when thousands of Israeli users make use of sites operated by LinkedIn, then there is a clear connection to Israel and there shall therefore be no reason for the Israeli courts to decline jurisdiction.<sup>4</sup>

In another case, the District Court recently ruled, in connection with a claim filed against the site operators of Booking.com, that a foreign company's website, which is operating in Hebrew, fulfils the 'majority of ties' rule and justifies jurisdiction over the claim in Israel.<sup>5</sup> Furthermore, the parties

should have a 'reasonable expectation' that various entities may be sued in the countries in which they operate.<sup>6</sup> This is even more accurate for large international corporations, which market their goods or services in many countries around the world.<sup>7</sup>

Similarly, it was determined in a suit filed against the operator of the Hotels.com website that a public interest, while examining the forum's adequacy, is the protection of Israeli consumers from a foreign company that markets its products or services throughout the Internet in the Hebrew language.<sup>8</sup>

In addition, it was determined in the matter of Booking.com, that where there are gaps between the power of the 'ordinary people' and a multi-national corporation, it is unreasonable to impose on the injured customer the burden of conducting legal proceedings overseas which are, of course, expensive.

The Israeli courts' ruling emphasised that, due to the development of the media and the means of international transport in the age of globalisation, the status of the Forum Convenient doctrine has diminished.<sup>9</sup> Accordingly, only when the balance between the ties to the Israeli forum and the ties to the foreign forum is clearly in favour of the foreign forum should an Israeli court waive jurisdiction authority in favour of the foreign court.<sup>10</sup>

Accordingly, the District Court ruled in a claim filed by the Israeli company, Tadbik Ltd against the international corporation Avery Dennison Corporation, that the default assumption is that the courts in Israel have jurisdiction to hear the disputes brought before them. The burden of proof to show that the Forum Convenient is not Israel is a heavy one, resting on the foreign corporation which claims it.

An exception is when the parties have agreed (in an agreement) on a jurisdiction clause that confers on a foreign court exclusive jurisdiction. When there is this type of clear and explicit provision, Israeli courts will enforce the clause and refuse jurisdiction in favour of the foreign court. However, as was the case with Tadbik, when there was no foreign jurisdiction clause, and the website of the foreign corporation only referred to the applicability of a foreign law, it was ruled that this provision was not a clear and explicit provision granting jurisdiction to a foreign forum that had been negotiated and agreed between the parties.<sup>11</sup>

Furthermore, in recent years, Israeli courts' rulings have also begun to erode this exception of foreign jurisdiction as well. It

is possible to overcome the stipulation of foreign jurisdiction, by arguing that giving effect to such a clause would amount to giving effect to a 'depriving condition' in a standard contract, according to the Standard Contracts Law.

Thus, for example, in the claim filed against PayPal, it was held that a provision set by PayPal which obliges its Israeli clients to litigate in Singapore and under Singapore law, is clearly a depriving condition, the sole purpose of which is to block claims by Israeli customers and it should therefore be annulled.<sup>12</sup>

The court stressed that PayPal, which provides service to a vast number of Israelis, should expect the possibility that it may be sued in Israel.

Following the same trend, the Court in the LinkedIn matter, ruled that in the age of the 'global village', and widespread use of the Internet, there is no longer room for the approach whereby the "plaintiff follows the defendant". Global corporations that provide their services worldwide via the internet should consider the risks of being sued wherever their customers reside.

It should be emphasised that, even in cases that did not concern giant international corporations, Israeli courts ruled that a foreign jurisdiction clause is, or might be considered, a depriving condition, so that the burden of proof to refute this presumption, will be on the company.

Thus in the matter of Forex Capital Markets Ltd, for example, the Court held that the trend of regarding clauses attributing jurisdiction to a foreign court as a depriving condition in a uniform contract has increased in recent years, especially in cases where Consumer Agreements were discussed and in cases where a foreign internet company sought to enforce its foreign jurisdiction clause with Israeli customers.

Under the same trend, it was ruled in the matter of Hotels.com that foreign jurisdictions clauses made between Israeli consumers and international corporations might be described as discriminatory and that this also applies with respect to smaller international companies.

However, despite the aforementioned trend, which favours the jurisdiction of the Israeli courts, the Supreme Court recently ruled in favour of a foreign international corporation (Facebook) which operates worldwide. The court accepted Facebook's argument that a class action filed against it in Israel should be conducted in Israel,

but according to the laws of the State of California.<sup>13</sup> The court held that the jurisdiction clause that states that any conflict between Facebook and its users shall be decided according to the laws of the State of California is not a depriving condition, since the investigation of the lawsuit under the laws of the State of California will not affect the rights of the Israeli customer seeking to sue Facebook. The California legal system has similar characteristics to the Israeli legal system and is considered to be one of the most advanced in the world in the field of class action lawsuits.

Second, unlike PayPal, where the choice of law was the laws of Singapore, in the case of Facebook the precedents and laws of the State of California are in English, which is understood by most citizens of Israel. Therefore, the interest of Facebook's Israeli users recede in the face of Facebook's interest to plan its steps according to one set of laws.

As a result, it was ruled that the jurisdiction clause was valid, and the case will be litigated in Israel, but according to the laws of the State of California.

In summary, the trend in Israel shows that the courts tend to retain jurisdiction to conduct claims against foreign corporations operating in Israel in cases where the 'majority of ties; is not clearly in favour of the foreign forum. In other words, if there is no excellent reason for the procedure to be conducted overseas, the court in Israel will recognise its authority to conduct the same in Israel.

In contrast, when there is a foreign jurisdiction clause in the agreement between the parties, the courts in Israel tend to refer the dispute to the foreign court chosen by the parties' country. However, even this trend has begun to diminish, while Israeli courts have overcome foreign jurisdiction stipulations by holding that these are depriving conditions, in accordance with the uniform laws of contracts.

#### Notes

- 1 LTD 9769/09 *Jane v John (Nevo)*, 20 October 2010, A.A. Goren, 'Issues in the Civil Procedure' edition 12, 81.
- 2 CAP 4716/93 *The Arab Society for Insurance Shchem v Zirikat*, PD (3) 265, ('the Zerikat Matter'); CAP2737/08 *Arbel v TUI AG* (published in Nevo on 29 January 2009) ('the Arbel Matter').
- 3 The Zerikat Case, supra note 2.
- 4 CA (Centre) 10822-02-15 *LinkedIn Corporation v Itay Lenuid (Nevo)*, 9 April 2017).
- 5 CA (Tel Aviv) 8295-10-17 *BOOKING.COM B.BV v Daniel Shapira (Nevo)*, 16 May 2018).
- 6 See, *Booking.com*, CPA 928/18 *De Neef Construction Chemicals BVBA v Gillar Ltd (Nevo)*, 15 May 2018) (the 'Gillar Matter'); CPA 2705/97 *GEVES A. Sinai (1989) v The Lockformer Co.*, v. (1) 109, 114 (the 'Plaster Matter').
- 7 See, the LinkedIn matter.
- 8 CA (Tel Aviv) 23241-09-16 *HOTELS.COM v Nadav Silis (Nevo)*, 21 June 2017).
- 9 See the Gillard Affair; the Plaster Matter.
- 10 See, Arbel; CA 3999/12 *Alzer Ltd v LINAK A / S*, (Nevo), 20 January 2014).
- 11 See, the above Tadbik matter; The judgment of the Supreme Court in the Gillar case as well as Tel Aviv (Honourable President of the District Court, S. Orenstein), 1744/09, *Bakhovitz Deborah v. Bank Hapoalim et al.* (Published in Nevo, May 30, 2010).
- 12 (centre) 39292-04 13 *Raz Klinghoffer v PayPal pte. Ltd (Nevo)*, 31 May 2015).
- 13 CP"P 5860/16 *Facebook Inc. v a Hemo (Nevo)* 31 May 2018) (the 'Facebook Matter').

## Cryptocurrency, litigation and the 'hard fork' remedy

As the world comes to grips with blockchain technology and cryptocurrency trading, litigators will seek to find innovative remedies to address losses associated with investments in the new assets and ventures.

The traditional remedies for damages, an account of profits or a constructive trust which, in effect, aim to see the claimant restored to the position they were in prior

to any offending act, are being relegated to secondary remedies in a recent class action issued in the United States Eastern District Court of New York<sup>1</sup> where the preference is for an order compelling a return of equivalent cryptocurrency to that lost during a hack of an international cryptocurrency exchange.

### Lee Pascoe

Norton Rose Fulbright,  
Melbourne

lee.pascoe@  
nortonrosefulbright.com

### BitGrail Srl and Nano: the incident

On 9 February 2018, a group of cryptocurrency investors trading on an Italian-based cryptocurrency exchange, BitGrail, were startled to discover that their investments in XRB, a cryptocurrency token created by Nano,<sup>2</sup> had disappeared from wallets stored at the BitGrail exchange. The alleged hack caused loss of approximately \$187m,<sup>3</sup> amounting to approximately 80 per cent of all XRB held at the BitGrail exchange and 15 per cent of all XRB that existed.<sup>4</sup>

Immediately, a war of words ensued between Francesco Firano, the director of BitGrail, and the Nano developers behind XRB. Mr Firano blamed the missing funds on a fault in the Nano protocol laying responsibility at the feet of the developers. He also pushed for a change in the blockchain protocol to 'roll back' (or 'hard fork') the blockchain in an effort to recover the funds.<sup>5</sup> In turn, the Nano developers accused Mr Firano of attempting to utilise a 'hard fork' for the purpose of covering up BitGrail's solvency issues. The Nano developers ultimately blamed the loss on a bug in the BitGrail exchange software.

### Every action has a reaction: the claims and court petitions

BitGrail halted operations on 9 February 2018 with talk by the director of compensating the XRB investors through a variety of means, including repayment plans, on the condition that investors executed appropriate releases prohibiting future litigation.<sup>6</sup> By April 2018, the BitGrail investors had seen little progress in the proposed compensation plans and initiated two actions to recover their XRB losses.

On 26 April 2018, a group of creditors petitioned the Court in Florence, Italy (the 'Italian Court')<sup>7</sup> to place BitGrail into bankruptcy pursuant to Article 6 of Italy's Bankruptcy legislation.

Notwithstanding the petition, BitGrail attempted to recommence trading on 2 May 2018. The Italian Court issued a temporary restraining order on the same date requiring the immediate closure of BitGrail until a final decision of the Court could be made. That final decision was handed down on 17 May 2018 where the Italian Court endorsed its earlier temporary restraining order and ordered the immediate and permanent shut down of the BitGrail exchange. Orders

were also made that the assets of BitGrail were to be held in the custody of a special administrator as part of a bankruptcy proceeding. Cryptocurrency assets were subsequently seized from the company's wallets on 15 June 2018.

While the European creditors pursued relief against BitGrail, through initiating bankruptcy proceedings, a further group of effected XRB investors fronted by Alex Brola launched a class action in the United States Eastern District Court of New York against the developers of XRB ('Class Action'). Mr Brola held a cryptocurrency customer account at BitGrail for the purpose of investing in and exchanging XRB.

The Class Action Complaint includes numerous allegations around the status of XRB as a security and the failure of Nano to register its initial offering in accordance with US securities law. Although, the more interesting allegations surround the loss of the cryptocurrency assets<sup>8</sup> insofar as the class alleges that the developers created XRB, directed prospective XRB investors to BitGrail while negligently misrepresenting that BitGrail had adequate safety measures in place to safeguard the assets of the XRB investors and when, in February 2018 the XRB was lost from the exchange, the developers disavowed responsibility for that loss. The claim goes further into alleging that the developers were involved in a civil conspiracy in making false, misleading and reckless statements and intentionally withholding facts from the BitGrail investors in a concerted effort to obtain their funds and cryptocurrency assets.<sup>9</sup>

The relief sought, as a direct and proximate result of the developer's alleged conspiracy, is an order that: '...NANO 'rescue fork' the allegedly missing XRB into a new cryptocurrency in a manner that would fairly compensate Plaintiff and the Class for each missing XRB and would eliminate all of the 'missing' XRB.'<sup>10</sup> ('hard fork remedy').

In addition, orders are sought for equitable restitution including: first, rescission of the investments in their XRB-held accounts at BitGrail; second, a return to the plaintiffs of all cryptocurrency or fiat currency paid as a result of the alleged unlawful and unfair business practices and conduct, an order for an accounting of the remaining funds and assets raised from the class in connection with XRB and an order imposing a constructive trust over the funds and assets rightfully belonging to the class.<sup>11</sup>

### Cryptocurrency losses and the 'hard fork' remedy

The hard fork remedy would require a fundamental change to the underlying protocol or consensus of the Nano blockchain to enable the creation of two blockchains.

Practically, the hard fork remedy would require the developers to rewrite the XRB code with the aim of eliminating the 'missing' XRB from the blockchain. In theory, a commensurate number of new XRB tokens could then be distributed to each affected BitGrail user. However, consideration may not have been given to what is to happen to investors who may have inadvertently acquired the 'hacked' XRB. If such tokens were legitimately transacted by innocent investors after the hack, it would be inequitable to 'eliminate' that stolen XRB in order to compensate another group of BitGrail investors.

Furthermore, even if the hard fork remedy can be affected by algorithmic adaptation, the legal basis for such a remedy is still to be considered by the courts. Thought need also be given to the practicalities of implementing a hard fork when all participants in the blockchain ecosystem need to participate in order to initiate the remedy. The practicality and enforceability of such an order both within the US and in other jurisdictions in which there are network participants may, therefore, be questionable.

### Legal issues associated with the 'hard fork' remedy

The cause of action for which the hard fork remedy is sought is founded on a claim of negligent misrepresentation and/or the participation of the developers in an alleged civil conspiracy. However, the outcome of those alleged actions is that 'property' of the investors was misappropriated. Pursuant to first legal principles, losses accruing as a consequence of this type of conduct is usually compensated by damages. The volatility of the market for cryptocurrency makes it difficult to assess damages as against lost tokens. As such, from an investor's perspective, the return of the token itself may prove a more equitable remedy in circumstances where there has been an appreciation in value of the lost asset.

The basis on which cryptocurrency communities operate is decentralisation. There is no one manager or central authority

that can affect the hard fork in isolation. Therefore, notwithstanding that an order can be made against the developers, the actual implementation of that remedy requires the co-ordination of the community of blockchain users. It is unclear how such an order, as against parties to a proceeding, could compel the rest of the community of users of the Nano blockchain to implement that remedy. Therefore, compelling a group of developers to undertake a 'hard fork' may do little more than place those individuals in breach of the court's orders if they have no ability to compel the rest of the community to take the necessary steps to effect the orders.

Furthermore, if a change to the blockchain is introduced by a hard fork then participants that do not upgrade to the new consensus rules will be unable to participate in the new system and will be forced onto the previous blockchain. The old minority blockchain is likely to suffer under the old consensus rules causing a reduced ability to effectively mine blocks on the blockchain. Arguably, the reduced efficiency of the old blockchain could, in fact, create loss for those XRB investors that were not affected by the hack but whose assets remain on the old (and less effective) blockchain.

Questions also need to be raised in relation to the ongoing obligation of the developers to continue to support the new fork evolving from the recoding. In theory, the developers could execute the code to abide by the Court order and then abandon the new fork in preference for working on solutions for the old fork on which their own investments are alleged to be held, thereby potentially leading to the devaluation of the new tokens issued to allegedly aggrieved investors.

The actual compensation consequent upon a hard fork may also fail to meet the loss allegedly suffered by the class members. Tokens produced by a hard fork will not be the same as the original tokens. Rather, they are a one-to-one match of old tokens for new, intended to be allocated only to the persons aggrieved. Such an action may actually confuse the market and create a reduced market for the cryptocurrency, potentially causing further loss, including to those investors who were not the subject of the hack or the court order but who continue to hold the original cryptocurrency assets.

Moreover, the new tokens may not hold the same value as the current cryptocurrency. As a market dictates the value of any cryptocurrency, it is not beyond possibility

that the market for the new XRB will be at a premium if a trading platform is established that deals solely with the new token and its demand becomes high in that market place. Alternatively, and more commonly, the new token is devalued and the hard fork will be of little value as compensation to those investors with loss arising from the hack.

Additionally, how is the court to mandate the value of a new token following a hard fork? Simply awarding the same 'number' of tokens to persons aggrieved may have the effect of providing the class with a windfall if the market has increased since the claim was filed. Issuing more tokens to compensate for losses in market value will clearly also yield an inequitable result when consideration is given to the BitGrail XRB holders as being only 15 per cent of the holders in the overall marketplace. Does a court have a basis to, in effect, prefer one group of cryptocurrency investors to the remainder in the marketplace in circumstances where the market for that cryptocurrency may have faltered since the filing of the claim?<sup>12</sup>

Finally, there are philosophical deterrents for a court contemplating the Hard Fork Remedy. Primarily, a precedent would be set for compensation for victims of a hack in circumstances where investors who trade cryptocurrency through an exchange should anticipate that the increased returns might come with an element of risk. In particular, the volatility of the market and high returns are a trade-off for the deregulation of the asset and lack of centralisation that would ordinarily serve to resolve and compensate investors for loss to the extent prescribed by law. A hard fork is unlikely to fix the overarching issues associated with investors trading on platforms that are exposed to an element of risk from hackers and/or associated issues of deregulation. Furthermore, such

a remedy is unlikely to act as a deterrent to perpetrators of the actual hack. In fact, the effect of the hard fork may create loss for other investors or market participants if the remedy imposes on the market a cryptocurrency with less intrinsic value than that of the original investment.

We can only wait and see how the court will grapple with the competing issues of theoretically compensating victims of a cryptocurrency theft, on the one hand, and, on the other, creating a precedent award that may be practically unenforceable in the new blockchain ecosystem, in which such orders would need to be operational.

#### Notes

- 1 *Alex Brota, individually and on Behalf of All Others Similarly Situated v. NANO f/k/a RAIBLOCKS f/k/a HIEUSYS, LLC*, a Texas company & Ors, United States District Court of Eastern District of New York.
- 2 Nano runs a payment platform that operates on its own unique blockchain.
- 3 17m Nano/XRB were allegedly stolen from the wallets of the investors stored on the BitGrail exchange.
- 4 See no. 1 above at 47.
- 5 'Italian Court Rules Bankrupt Crypto Exchange BitGrail Must Stay Closed' (Action News, 24 May 2018).
- 6 [www.bitgrail.com](http://www.bitgrail.com), 'News'.
- 7 BonelliErede, the law firm acting for the creditors, has indicated that it acts on behalf of some 3,000 BitGrail users (see Peyton A, 'Italian cryptocurrency exchange BitGrail's quest halted', 23 May 2018, <http://bankingtech.com/author/anthonypeyton/>).
- 8 The discussion around the claim that tokens in an ICO offering are securities is beyond the scope of this paper. The reader should note that there has been no court determination to date in the United States as to whether ICO tokens fall within the definition of 'securities' for the purpose of US securities law. However, on 7 June 2018 a statement of Jay Clayton, Chairman of the US Securities and Exchange Commission, indicated that, in his view, all ICO tokens classify as securities.
- 9 See no. 1 above at 122.
- 10 See no. 1 above at 24, Prayer for Relief (d).
- 11 See no. 1 above 24, Prayer for Relief (d), (f) and (g).
- 12 As an example of XRB's volatility, in December 2017 XRB traded between \$0.20 and \$32. 'Class Action filed against Nano team, demands "Rescue Fork" for lost BitGrail Funds' (CoinCentral.com, 10 April 2018).



# IBA 2019



COEX CONVENTION & EXHIBITION CENTER

SEOUL, SOUTH KOREA, 22–27 SEPTEMBER



The 2019 Annual Conference will be held in Seoul, South Korea, a thriving metropolis where modern skyscrapers, high-tech subways and pop culture meet Buddhist temples, palaces and street markets.

South Korea is a world leader in electronics, consumer goods, shipbuilding, auto vehicle manufacturing and steel making, with some of the largest Korean companies such as Samsung, LG and Hyundai now household names. South Korea is the 4th largest economy in Asia and the 12th largest in the world and is one of the fastest growing developed economies.

Seoul is developing as a design, fashion and technology centre, and breaking out as a key business hub. This technology forward, but deeply traditional city, will be an ideal location for the largest and most prestigious event for international lawyers, providing an abundance of business and networking opportunities.

## WHAT WILL IBA 2019 OFFER YOU?

- Gain up-to-date knowledge of the key developments in your area of law which you can put into practice straight away
- Access to the world's best networking and business development event for lawyers and law firms – attracting over 6,000 individuals representing over 2,700 law firms, corporations, governments and regulators from over 130 jurisdictions
- Build invaluable international connections with leading practitioners worldwide, enabling you to win more work and referrals
- Increase your personal and law firm's profile in the international legal world
- Hear from leading international figures, including officials from the government and multilateral institutions, general counsel and experts from across all practice areas and continents
- Acquire a greater knowledge of the role of law in society through rule of law and human rights
- Be part of the debate on the future of the law

## TO REGISTER YOUR INTEREST:

Visit: [www.ibanet.org/Form/IBASeoul2019.aspx](http://www.ibanet.org/Form/IBASeoul2019.aspx)

Email: [ibamarketing@int-bar.org](mailto:ibamarketing@int-bar.org)

To receive details of all advertising, exhibiting and sponsorship opportunities for the IBA Annual Conference in Seoul, email [andrew.webster-dunn@int-bar.org](mailto:andrew.webster-dunn@int-bar.org)

OFFICIAL CORPORATE SUPPORTER

