

TheGavel

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Chadbourn Represents New York State Judges in Dispute Over Pay Raise

On September 12, 2007, on a pro bono basis, Chadbourne filed an action in New York State Supreme Court in New York County on behalf of four State Court judges against Eliot Spitzer, as Governor of the State of New York, the New York State Senate, the New York State Assembly, and the State of New York as defendants. Plaintiffs bring claims for a declaratory judgment seeking a finding that New York has violated its own Constitution by failing to provide plaintiffs with a pay raise since 1999 to off-set the increase in cost of living and to account for 26% inflation since 2000. New York has gone longer than any other state in implementing raises for its judges, and it ranks 48th in the nation in judicial salaries when New York's high cost of living is factored into the assessment.

Specifically, Plaintiffs assert that this failure violates Article VI, Section 25 of the New York Constitution which forbids the diminishment of judges' salaries during their term on the bench, and claim that the effect of inflation since 1999 results in a de facto diminishment of judicial salaries. In addition, Plaintiffs claim that the State's practice of coupling judicial salary raises with those of the other government branches results in a violation of the doctrine of Separation of Powers. By linking judicial salary raises to

those of the other branches, the State has unavoidably breached the distinction among the three branches, weakening an essential aspect of New York's form of government—the independence of the judiciary. In addition to seeking a declaratory judgment, Plaintiffs seek immediate pay raises and back-pay to fully compensate for wages that have been

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Judges' Suit

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unconstitutionally denied and to account for the significant cost of living increase since 1999.

New York partners Thomas Bezanson and George Bundy Smith are leading the Chadbourne team. ©

More Bondholders Pursue Claims for Late Filings

Our first issue of *The Gavel* noted the potential significance of the decision of the New York State Supreme Court, Commercial Division, in *Bank of New York v. BearingPoint, Inc.*, No. 600169/06, 2006 N.Y. Misc. LEXIS 2448 (N.Y. Sup. Ct. Sept. 18, 2006). In that case, the court held that a bond issuer had violated the terms of its indenture by failing to file financial reports with the Securities Exchange Commission ("SEC") and the indenture trustee. Recent developments suggest that other bond holders—but perhaps not other courts—have taken that court's decision to heart.

First, in *Cyberonics, Inc. v. Wells Fargo Bank National Association*, No. H-07-121, 2007 WL 1729977 (S.D. Tex. June 13,

"deliver to the Trustee within fifteen days after it files them with the SEC copies of the annual reports and of the information, documents and other reports (or copies of such portions of any of the foregoing as the SEC may by rules and regulations prescribe) which the company is required to file with the SEC pursuant to Section 13 or 15(b) of the Exchange Act." *Id.* at *1. The Court found that such provision "unambiguously requires only that Cyberonics deliver copies of the annual reports and other documents to Wells Fargo within fifteen days after having filed those documents." *Id.* at *4. The Court declined to read into that provision a requirement that the documents actually be filed with the SEC in a timely fashion. *Id.*

The court expressly rejected adherence to the decision in *BearingPoint*, noting that the *BearingPoint* decision was an unpublished decision by a trial-level-judge, and that an appeal of that decision had been withdrawn before resolution. *Id.* at *5. Thus, the court determined that it was not obligated to follow the reasoning set forth in *BearingPoint*. *Id.* Moreover, the court noted that, in *BearingPoint*, the filing at issue had never been made, and that the trustee therein had waited for a significant period of time before seeking acceleration. *Id.* In this case, by contrast, the court noted that the 10K filing at issue, although late, was made shortly after the acceleration notice was received and that Cyberonics had

Bondholders still have much to gain by pursuing technical defaults such as late SEC filings.

2007), the United States District Court for the Southern District of Texas, Houston Division, rejected the contention that the failure of Cyberonics to file its Form 10K with the SEC in a timely fashion was a violation of its indenture that permitted acceleration of the due date of the principal under the notes. The indenture at issue required Cyberonics to

kept the trustee informed of company developments in the meantime. *Id.*

More recently, on August 1, 2007, Landry's Restaurant, Inc. ("Landry's") brought suit against certain holders of its 7.5% Senior Notes due in 2014 (the "Noteholders"). The Noteholders also attempted to accelerate the principal due

under such notes as a result of a late filing. According to the complaint filed in *Landry's Restaurant, Inc. v. The Post Advisory Group, LLC and Lord Abbett Bond-Debenture Fund, Inc.*, which was brought in the United States District Court for the Southern District of Texas, Galveston Division, Landry's had never missed a payment or committed any other breach of its indenture. However, in March 2007 it filed a form with the SEC seeking a fifteen day extension to file its Form 10K. Shortly thereafter, Landry's received a letter from the indenture trustee under its 7.5% Senior Notes due in 2014 claiming that the failure to file a timely Form 10K was a default under the terms of the governing indenture and the Trust Indenture Act of 1940. According to the complaint, Landry's responded by telling the trustee that Landry's had filed the necessary form to obtain an extension of time in which to file its 10K, and by rejecting the argument that the failure to file was an event of default. Nevertheless, on July 24, 2007, Landry's received a Notice of Acceleration from the trustee. Thereafter, a group of the Noteholders formed an "ad hoc committee," purportedly to negotiate a resolution of the dispute with Landry's.

On August 1, 2007, Landry's brought suit. In its complaint, it contended that the actions of the Noteholders were in violation in the terms of the indenture and the Trust Indenture Act, and also amounted to tortious interference with Landry's business relations and commercial disparagement. Landry's averred that it suffered significant damages as a result of these activities because the lower credit rating resulting from the accusation that it was in default increased its cost of capital, the resulting publicity caused a decline in Landry's stock price, and the company was forced to expend significant amounts on attorney's fees contesting the allegations. Complaint ¶ 28. Landry's also claimed that the ad hoc committee that had been formed was in violation of a specific provision of the indenture that prohibited such joint activity on the part of the Noteholders. Complaint ¶ 29. Upon filing the complaint, Landry's sought and obtained a temporary restraining order, preventing the trustee and the Noteholders from accelerating the principal due on Landry's notes pending a full hearing on the matter.

On August 16, 2007, the court held a hearing on Landry's request for injunctive relief pending final resolution of its claims. The judge adjourned the hearing and ordered Landry's to meet with the Noteholders for settlement negotiations. As a result of the negotiations, Landry's and the

Noteholders entered into a Stipulation of Settlement.

According to the settlement, the Noteholders would rescind the acceleration notice in return for a \$3 million consent fee from Landry's. See Form 8-K filed on August 29, 2007, by Landry's Restaurant's Inc. Landry's would also agree to exchange the 7.5% Senior Notes for new Senior Notes with a 9.5% interest rate. *Id.* Landry's also agreed to pay all reasonable attorneys' fees and to dismiss the pending litigation against the Noteholders. *Id.* The court dismissed the complaint with prejudice on August 30, 2007.

Despite the *Cyberonics* decision, it appears from the Landry's settlement that bondholders still have much to gain by pursuing technical defaults such as late SEC filings. Unless companies begin to clarify in their indentures whether documents must be filed with the SEC in a timely manner to avoid technical default, or a higher court rules on the issue, this trend will likely continue. ☺

Significant Decision for International Investment Banks: Australian Judgment Highlights Importance of Disclaimers of Fiduciary Duty in Investment Banking Engagements and Maintenance of "Informational Barriers"

In a case that has been closely followed by the international investment banking industry, the Federal Court of Australia recently issued a judgment upholding the enforceability of the disclaimer of fiduciary duty by the Australian arm of Citigroup Inc. ("*Citigroup*") in the mandate letter pursuant to which Citigroup provided investment banking advisory services in connection with a proposed corporate takeover. The

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decision, which addresses both the nature of relationships that can give rise to fiduciary responsibilities on the part of investment banks and the effectiveness of contractual provisions disclaiming any fiduciary relationship, is particularly noteworthy in view of the prevalence of such contractual provisions in engagement and mandate letters to address and resolve issues of conflict of interest. Such conflicts frequently arise as a result of the multiple roles played by international banks and their investment banking divisions in complex financial transactions.

Overview of the Citigroup Decision

In *Australian Securities and Investments Commission v. Citigroup Global Markets Australia Pty Limited*, (ACN 113 114 832) (No. 4) [2007] FCA 1963, issued June 28, 2007, the Australian Court dismissed claims for breach of fiduciary duty brought against Citigroup by its corporate regulator, the Australian Securities and Investments Commission (“ASIC”), which Citigroup had vigorously challenged based upon, among other things, the terms of the mandate letter under which Citigroup had been retained by a large public company to advise on a proposed takeover.

The mandate letter expressly provided that Citigroup

tion obtained from any customer.” ASIC contended that in order for a contractual provision between a fiduciary and its client that would create an actual or potential conflict of interest to be effective, the fiduciary must obtain the client’s informed consent to the inclusion of that provision.

ASIC’s claims were based on alleged conflicts of interest as a result of Citigroup, through one of its proprietary traders, having engaged in trading of shares of a company that was the target of the proposed takeover at a time when Citigroup’s Investment Banking Division was advising its client in connection with the proposed takeover bid. The Court explained that Citigroup sought to manage such potential or actual conflicts by means of establishing “Chinese Walls” or “informational barriers” between those employees working on the “public side” of Citigroup’s business, known as “public side” employees, and those employees working in areas where they are exposed to inside information, or so-called “private side” employees. The proceedings arose out of the purchase by a public side employee of shares of the target company for Citigroup’s proprietary account when private side employees in the Investment Banking Division were acting for the acquiring company in connection with its proposed takeover bid, which was announced on the following trading day. When the purchases by the trader on the public side became known to private side

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would be acting “as an independent contractor and not in any other capacity including as a fiduciary.” The letter also contained confidentiality provisions, whereby Citigroup agreed that “we will not use confidential information obtained from the Company except in connection with our services to, and our relationship with, the Company, nor will we use on the Company’s behalf any confidential informa-

employees, steps were taken to instruct him to stop buying shares of the target company, and shortly after receiving those instructions, the trader sold a portion of the block of shares that he had purchased earlier that day.

These factual circumstances resulted in two categories of claims by ASIC. First, ASIC contended that the circumstances gave rise to various conflicts of interest between Citigroup

and its investment banking client that supported claims of breach of fiduciary duty, including an alleged conflict between Citigroup's interest in making a profit on the shares purchased for its own account and the client's interest that the price of the shares of the target company not increase. Second, ASIC also asserted claims for insider trading in alleged violation of the Australian Corporations Act based on the sale of the shares in the target company following a conversation between the trader and his superior prior to the announcement of the takeover bid.

All of the claims of conflict of interest were predicated on

factual matter, the client had sufficient awareness of the possibility of proprietary trading in the shares of the target company so as to constitute informed consent.

The Court also dismissed ASIC's insider trading claims on various statutory and factual grounds, including that Citigroup was entitled to maintain a Chinese Wall defense as provided for under the terms of the Corporations Act. Moreover, the Court specifically rejected the notion advanced by ASIC that Citigroup should have been required to bring proprietary traders "across the Chinese Wall" in the run up to the public announcement of the bid so as to prevent them

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the existence of a fiduciary relationship between Citigroup and its investment banking client, without which the claims would fail. The central issue in the case accordingly was whether the mandate letter by its terms effectively excluded a fiduciary relationship. Relying on both Australian and English authorities, the Court initially found that it is open to the parties to a contract to exclude or modify the operation of fiduciary duties.

ASIC argued that Citigroup was required to obtain informed consent to the waiver of a fiduciary relationship, by expressly disclosing that the effect of the exclusionary language was to permit Citigroup to trade shares of the target company for its own account, in potential conflict with the interests of its client. The Court rejected the contention that Citigroup was required to obtain informed consent to the contractual exclusion of a fiduciary relationship, holding that such a requirement only applied (i) if the fiduciary falls within an established or per se category of fiduciary relationships, such as the one that exists between lawyer-client, or (ii) the fiduciary was subject to fiduciary obligations before entering into the contract. The Court also found that, as a

from trading in the shares of the target company.

The Citigroup decision is of particular importance because it appears to be the first reported case to uphold the enforceability of such contractual exclusions of fiduciary duties in the investment banking context. Moreover, because the decision is grounded in both Australian and English legal principles, it can be expected to have precedential value with courts and regulatory agencies in various countries that look to English law in regulating international investment banks, including the Financial Services Authority in the U.K. The decision also provides persuasive authority in the United States to the extent that it is based upon principles of common law, although the enforceability of such exculpatory provisions has not been the subject of a reported decision in the U.S.

United States Decisions Regarding Fiduciary Duties of Investment Banks

The Citigroup decision reinforces the importance of clear, appropriate, and sufficiently detailed disclaimers of any fiduciary relationship in financial advisory engagement agree-

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ments to avoid claims of breach of fiduciary duty based on alleged conflicts of interest. In the United States context, the use of such disclaimers has become an increasingly standard practice in response to the decision of the Ninth Circuit in *In re Daisy Systems Corp.*, 97 F.3d 1171 (9th Cir. 1996). The decision also underscores the importance of maintaining and enforcing appropriate informational barriers as a defense to allegations of conflict of interest.

In *Daisy Systems*, Bear Stearns and Co. was engaged by Daisy Systems Corporation (“Daisy”) to provide advisory services in connection with Daisy’s proposed acquisition of a public company. After Daisy was placed in involuntary bankruptcy, its Chapter 11 Trustee brought claims against Bear Stearns, including for breach of fiduciary duty in connection with Bear Stearns’ advice to adopt a hostile takeover strategy. The Court rejected the argument that the relationship between an investment banker and the banker’s client is not a fiduciary relationship as a matter of law. Rather, the Court held that whether a fiduciary relationship existed is a question of fact, resolution of which requires consideration of the particular facts and circumstances of the relationship at issue. In particular, the Court observed that determining whether a fiduciary relationship arises depends on resolution

ment underwriting of the initial public offering of shares of eToys. The Court held in *EBC I, Inc. v. Goldman, Sachs & Co.*, 5 N.Y.3d 11, 799 N.Y.2d 170 (2005) (“eToys”), with a sharp dissenting opinion by Judge Read, that the underwriter of an IPO may owe a fiduciary duty to the issuer.

In eToys, the complaint alleged an advisory relationship that was independent of the underwriting agreement, based upon eToys having allegedly reposed confidences in Goldman Sachs’ knowledge and expertise to advise it as to a fair price for the IPO. Plaintiff, the Official Committee of Unsecured Creditors, alleged that based on this advisory role, Goldman Sachs had a fiduciary responsibility to disclose any conflict of interest regarding the pricing of the IPO. The complaint alleged that Goldman Sachs breached this duty by allegedly concealing from eToys its divided loyalty arising from arrangements whereby Goldman Sachs sold portions of its allotment to favored customers (known as “spinning”), who in turn “kicked back” to Goldman Sachs a percentage of the profits made by quickly selling in the aftermarket (known as “flipping”).

The Court held that a fiduciary duty may exist on the part of the underwriter, but stressed that the underwriter’s fiduciary duty is limited to the underwriter’s role as an expert advisor. *Id.* at 21. Accordingly, the fiduciary relationship recognized in eToys is analogous to the confines of the fiduciary rela-

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of the issues of whether the client reposed confidences in the investment banker and whether an agency relationship existed. *Id.* at 1178-79.

More recently, the New York Court of Appeals addressed the issue of whether a fiduciary relationship may be asserted in a complaint based upon the investment bank’s advisory role as an underwriter in connection with a firm commit-

ment set forth in *Daisy Systems*, based upon the investment banker fulfilling an advisory role with respect to market strategy and pricing in a takeover transaction.

Judge Read dissented on grounds that creating a fiduciary duty on the part of the lead underwriter in a firm commitment underwriting to disclose conflicts of interest in connection with the pricing of the securities is at odds with the

Court's precedent and potentially conflicts with the complex regulatory scheme established to protect investors. First, the dissent noted that the offering price for the IPO was negotiated between sophisticated parties represented by counsel. Accordingly, the dissent questioned "[h]ow may a buyer owe a duty of the highest trust and confidence to a seller regarding a negotiated purchase price?" since the "interests of a buyer and seller are inevitably not the same." *Id.* at 26. Second, the dissent argued that creating a fiduciary duty for

company's interests. The engagement letter may also provide specific examples of potential conflicts, such as the bank's engaging in trading of securities or financial products of one of the entities connected with the particular transaction for its own account or on behalf of other clients. For purposes of obtaining informed consent, the engagement letter will require the client to agree or acknowledge based upon the disclosures that the bank is not required to restrict its activities and may undertake any business activity without notify-

The Citigroup decision is of significance to investment banks operating in the United States and abroad because of its recognition of the enforceability of contractual exclusions of fiduciary obligations.

underwriters in their advisory role represented judicial intervention in an area "better dealt with by specialized regulators than by the evolving common law." *Id.* at 28.

Financial Advisory Engagement Letters and Obtaining Informed Consent

The Citigroup decision, particularly when read in conjunction with cases such as *Daisy Systems* and *eToys*, also underscores the advisability of including language that expressly provides for informed consent as a means of reducing the risk of litigation arising from potential conflicts of interest.

Accordingly, investment banks are in practice using language in financial advisory engagement letters that provides for informed consent to the client's waiver of conflicts of interest, in addition to language disclaiming any fiduciary relationship.

In this regard, the engagement letter will typically contain language to the effect that the client company recognizes that that the bank is engaged in a wide range of financial services, such as investment management, financing, securities trading, corporate and investment banking, and research, which may give rise to conflicts with the client

ing the client.

Furthermore, to protect the confidentiality of client information in situations where potential or actual conflicts may arise, engagement letters for investment banking financial advisory services typically will also include language to the effect that the client agrees that the bank has no duty to disclose to the client any information derived from such other, potentially conflicting business activities, and will not use any confidential information obtained from the client, except in connection with its services to the client.

Conclusion

The Citigroup decision is of significance to investment banks operating in the United States and abroad because of its recognition of the enforceability of contractual exclusions of fiduciary obligations. The enforceability and scope of such exclusionary provisions, however, have not yet been challenged in litigation in the United States. The decision also emphasizes the importance of maintaining and enforcing procedures for informational barriers within banking operations to defend against claims based on alleged conflicts of interest.

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Through appropriate contractual exclusionary provisions, and the maintenance of informational barriers as reflected therein, banks providing investment banking services to clients around the world will be in a better position to avoid exposure to claims of breach of fiduciary duty based on alleged conflicts of interest, and successfully to defend against such claims as occurred in the Australian litigation in Citigroup. ©

District Court Compels Arbitration in a Foreign County Despite Parties' Failure to Identify Specific Arbitration Location

In *Apple & Eve v. Yantai North Andrew Juice Co.*, No. 07-CV-745-FJB-WDW, 499 F. Supp. 2d 245 (E.D.N.Y. June 20, 2007), the United States District Court for the Eastern District of New York addressed whether a U.S. court must compel arbitration

New York, had entered into two contracts with defendant Yantai North Andre Juice Co. Ltd., a corporation organized under the laws of the People's Republic of China and with its principal place of business in Yantai, Shandong Province, China, whereby defendant was to supply juice concentrate to plaintiff. *Id.* at 246. Each contract contained an arbitration clause, providing that, in the event of a dispute between the parties arising under the contract, "if no settlement can be reached, the claim in dispute shall then be submitted or [sic] arbitration in the country of defendant in accordance with the arbitration organization of the defendant country." *Id.*

Despite the apparent obligation to arbitrate disputes in China, plaintiff brought an action against defendant in the Supreme Court of the State of New York, County of Nassau, claiming defendant breached certain of its obligations under the contracts. *Id.* at 247. Defendant subsequently removed the action to federal court and filed a motion to compel arbitration in June 2007. *Id.*

The parties agreed that the motion to compel was governed by the 1958 Convention on the Recognition and Enforcement of Arbitral Awards (the "New York Convention"), which was adopted "to encourage the recognition and enforcement of commercial arbitration agreements in international contracts." *Id.* (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 520 (1974)). Under the New York Convention, a court "may direct that arbitration be held in accordance with

The Eastern District of New York addressed whether a U.S. court must compel arbitration in a foreign country despite the parties' failure to identify a specific arbitration location and arbitration organization in their arbitration agreement.

in a foreign country despite the parties' failure to identify a specific arbitration location and arbitration organization in their arbitration agreement.

Plaintiff, Apple & Eve LLC, a Delaware limited liability company with its principal place of business in Nassau County,

the agreement at any place herein provided for, whether that place is within or without the United States." *Id.* (quoting 9 U.S.C. § 206).

The court noted precedent holding that, upon a finding that an arbitration agreement exists, a federal court must

compel arbitration of any dispute within the scope of the agreement, unless the court “finds that the said agreement is null and void, inoperative or incapable of being performed.” *Id.* at 247-48 (quoting 9 U.S.C. § 201). Because the parties did not contest the existence of an arbitration agreement or that the dispute fell within its scope, the court held

tion agreement would be invalid in China due to its failure to specify an arbitration organization. Under the Arbitration Law of the People’s Republic of China (“PRC”), an arbitration agreement must designate one of the 186 arbitration commissions in China as the body to hear the dispute, should one arise. *Id.* However, the failure to designate a particular

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that an order compelling arbitration was required under § 206 unless the “null and void” exception applied. *Id.* at 248.

Plaintiff asserted two reasons in support of its contention that the arbitration agreement was “null and void” under § 201: (1) the parties’ failure to specify a specific situs within China was a mistake, and (2) the parties’ failure to specify an arbitration commission made the agreement, under Chinese law, incapable of being performed. *Id.*

The court first noted that the “null and void” exception is to be construed narrowly, and is usually limited only to internationally recognized defenses such as fraud, mistake, duress and waiver. *Id.* at 248-49.

The court rejected the plaintiff’s first argument, holding that failure to identify a particular situs for arbitration does not constitute a “mistake” under § 206. *Id.* at 249. Unlike in the cases that the plaintiff relied on, where the parties had specified a non-existent forum, ambiguous fora, or no country at all for arbitration, the parties in the instant case had “unambiguously identified a location” for arbitration: China. *Id.* at 249-50. Because the New York Convention does not explicitly require the parties to designate a situs more specific than the country of a signatory to the New York Convention, and in light of strong federal policy in favor of arbitration, the court held that failure to specify a city or region within China does not provide a basis for denying a motion to compel arbitration. *Id.*

Next, the court addressed the contention that the arbitra-

arbitration organization does not automatically render the agreement null and void; rather, the agreement is invalid only if the parties do not reach a supplemental agreement designating the arbitration commission. *Id.* at 250. The court acknowledged several PRC cases that held arbitration clauses invalid where the arbitration clause did not identify an arbitration commission and no supplemental agreement was reached. *Id.* at 250-51. The court, however, refused to find, on the facts presented to it, that the parties had been unable to come to a supplemental agreement. The plaintiff argued that the act of filing a lawsuit against defendant was sufficient under the laws of the PRC for the court to conclude that no supplemental agreement could be reached, citing PRC precedent holding that instituting an action in a PRC court constitutes failure to reach a supplemental agreement. *Id.* at 251. The court noted, however, that no PRC case cited by the plaintiff held that merely filing an action in a foreign jurisdiction (such as the United States) was sufficient for a court to conclude that the parties could not reach a supplemental agreement. *Id.* at 251-52. The court refused to conclude that (1) “the parties would not reach a supplemental agreement if compelled to arbitrate in China” or (2) “if no supplemental agreement were reached, the Arbitration Clause would be declared void by a Chinese arbitration commission or a Chinese Court, under Chinese arbitration law.” *Id.* at 252.

The court also took note of a recent promulgation of the

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Supreme People's Court of the PRC directing courts to deem an arbitration institution selected even when the name of the arbitration organization stipulated in the agreement is inaccurate (so long as the correct organization can be identified). *Id.* at 253. This liberalization of the arbitration rules “serve[d] to further caution” the court against declaring the instant arbitration agreement invalid in China, “especially

September 27, 2007). The Court held that Plaintiff failed to state a claim upon which relief could be granted. *Id.* at *1.

Germany made two arguments in requesting dismissal. First, it argued that the Court lacked subject matter jurisdiction under the Foreign Sovereignty Immunities Act (“FSIA”), pursuant to which foreign sovereigns generally are immune from domestic lawsuits. *Id.* at *11-12. Following United States Supreme Court precedent and holding that Germany’s assumption of liability for the bonds was a “commercial

The court refused to decide as a matter of law that the arbitration agreement was incapable of being performed in China.

where plaintiff has cited no PRC cases that have addressed the precise factual circumstances presented here.” *Id.*

Because the defect in the arbitration agreement was curable, and “[g]iven the factual and legal variables required for the agreement to be declared invalid in the PRC,” the court refused to decide as a matter of law that the arbitration agreement was incapable of being performed in China. *Id.* at 252. The motion to compel arbitration was granted. ©

Recent Decision Addresses Germany’s Liability Under Bonds

A court in the Southern District of New York recently dismissed a lawsuit filed against the Federal Republic of Germany that sought to recover the principal and interest on bearer bonds, alleged to be valued at over \$400,000,000 and held by Plaintiff Mortimer Off Shore Services, Ltd. (“Plaintiff”). *Mortimer Off Shore Services, Ltd. v. Federal Republic of Germany*, No. 05 Civ. 10669 (GEL) 2007 U.S. Dist. Lexis 71906, at *1 (S.D.N.Y.

activity” that falls within an express exception to the FSIA, the Court found that it did have subject matter jurisdiction. *Id.* at *15, 24. Germany argued, in the alternative, that Plaintiff failed to comply with certain requirements to validate the bonds and that the Court could therefore grant no relief. *Id.* at *25. Plaintiff argued that validation of the bonds was not necessary. *Id.* at *41.

In 1953, Germany (which then encompassed only The Federal Republic of Germany or “West Germany”) entered into a treaty (the “Treaty”) with the United States for the settlement of obligations arising from German dollar bonds in order to satisfy debt incurred by Germany during World War II. *Id.* at *2. The Treaty incorporated the “Validation Law,” pursuant to which “West Germany assumed liability for ‘foreign currency bonds’” issued by banks both inside and outside West Germany prior to the end of World War II. *Id.* at *2 (citations omitted). Therefore, “[B]y operation of the Validation Law, West Germany assumed liability for certain bonds..., and by operation of the Treaty, its liability was extended to bonds offered in the United States.” *Id.* The Validation Law states that bonds cannot be enforced unless they are registered with “either the German Examining Agency or a Validation Board in the country of offering” for examination; failure to register ren-

ders the bonds unenforceable and invalid. *Id.* at *3.

Addressing Germany's first argument, the Court discussed precedent relating to similar bonds and whether Germany's assumption of the liability of the bonds was commercial, which triggers an exception to sovereign immunity under the FSIA. Under this commercial activity exception, "[A] foreign state is not immune from suit if, in relevant part, 'the action is based...upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.'" *Id.* at 10-11 (citations omitted). Following *Republic of Argentina v. Weltover, Inc* (504 U.S. 607, 611, 112 S. Ct. 2160, 119 L. Ed. 2d 394 (1992)), the Court held that Germany's assumption of liability for the bonds was a commercial activity and thus Germany was not entitled to sovereign immunity. *Mortimer*, 2007 U.S. Dist. Lexis 71906 at *16. The Court noted that it was not the governmental purpose of Germany's activity that was relevant, but rather the fact that assuming the debt of others is a common commercial activity. *Id.* at *17.

The Court did, however, agree with Germany that Plaintiff's failure to seek validation of the bonds warranted dismissal. Plaintiff conceded that it might need to comply with the Validation Law for that portion of its bonds issued

assume liability for debt of predecessor states through explicit acts that leave traces in legal documents" and that "such acts must be voluntarily and affirmatively undertaken by the successor state." *Id.* at *33 (citations omitted)(emphasis in original). The Court then addressed whether Germany assumed liability for the relevant bonds through a voluntary, affirmative and explicit act that could be interpreted and enforced by the Court, and found that that only relevant acts taken by Germany were the Validation Law and the Treaty. *Id.* at 33. Therefore, the Validation Law serves as the only source of Germany's liability for the Bonds. See *id.* at 26. Thus, if the Validation Law applies, as Germany argued, Plaintiff admittedly did not comply with its procedures. *Id.* If, as Plaintiff argued, the Validation Law does not apply, then Germany assumed no liability for those bonds. *Id.* Either way, the Court could not grant relief. *Id.*

The Court also held that Plaintiffs' claim may be reviewed in the future by the Court, a German court or an arbitration board if the bonds are deemed invalid by the "Validation Board." *Mortimer*, 2007 U.S. Dist. Lexis 71906 at *41. The Validation Law requires that, in order to be validated, the bonds must be registered within one year from "six months after August 25, 1953." *Id.* at *27. The one year deadline is extended to two years if failure to register is not a result of

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by banks in West Germany and that it therefore could not receive relief for those bonds, but argued that the Validation Law did not apply to the portion of its bonds backed by banks outside West Germany. *Id.* at *29. Plaintiff asserted that banks located outside West Germany were excluded from the Validation Law. *Id.*

Referencing prior S.D.N.Y. and Second Circuit decisions, the Court opined that, unlike private parties, "sovereigns can only

the registrant's "gross negligence." *Id.* Following registration, an administrative hearing is held, and the registrant must prove that the bond was held outside of Germany on January 1, 1945 and that the registrant was the "lawful acquirer" of the bond or that the bond was "restituted" to the registrant if it was confiscated prior to May 8, 1945. *Id.* at *27 (citing the Validation Law). The Court made no comment on Plaintiffs' apparent failure to meet the deadline for registration. ©

Newsworthy

- On October 1, 2007, Karl H. Buch joined Chadbourne as counsel in the New York office. Karl joined the firm from the United States Attorney's Office for the District of New Jersey in Newark, New Jersey, where he was an Assistant U.S. Attorney in the Criminal Division-Securities & Healthcare Fraud Unit. Karl represented the United States in criminal matters involving securities, corporate, bank, health care, tax and mortgage fraud, terrorism, espionage and racketeering. His responsibilities included investigating and prosecuting individuals and major corporations and their officers for violation of securities laws and other federal crimes. Prior to joining the United States Attorney's Office, Karl was an associate with Sullivan & Cromwell in New York. Prior to that, he had been a law clerk for United States District Judge John Sprizzo of the United States District Court for the Southern District of New York.
- On October 1, 2007, New York Partner Judge George Bundy Smith served as Chief Justice at a mock argument held at the Office of the Appellate Defender's Annual First Monday in October celebration. The title of the mock argument was "The Second Amendment, Who Has the Right To Own Guns?"
- New York Partner Thomas Bezanson will chair the Federal Bar Council's Annual Thanksgiving Luncheon in recognition of the federal judiciary. The luncheon will be held at the Waldorf Astoria on November 21, 2007.

Awards

- Several Chadbourne Commercial Litigation partners have been selected as 2007 New York Metro Super Lawyers and were listed in the New York Times Magazine on Sunday, September 23, 2007. They are: Thomas Bezanson, Thomas Butler, Thomas Hall, Thomas McCormack, Alan Raylesberg and Phoebe Wilkinson.

Publications

- New York partner Robert Schwinger authored an article on Law.com in August entitled "Will 'Leegin' Pave the Way for Ending Baseball's Antitrust Exemption?"
- New York counsel Gerard Citera recently authored two articles. His article entitled "Top Ten Regulatory Initiatives Affecting the U.S. Equity Trading Markets" was published in Bloomberg Law Reports, while his article entitled "Broker-Dealer Supervision: A New Paradigm" was published in Insight: The Corporate and Securities Advisor.

Contributors to this edition of *The Gavel* include: Thomas E. Butler, Robert Sidorsky, J. Carson Pulley, Bernadette Galiano, Erin Smith and Matthew Moody.

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