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No. 3 – September 3, 2015

Made in Germany

BusinessLawMagazine

In this issue

Focus: Brazil – Shareholder activism – M&A transactions – Standard-essential patents – Insolvency law – India: Foreign investments – Hot spot: Arbitration in Asia

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Business Law Magazine: Asia, Brazil, India – and much more

Dear Reader,

Brazil, India and Asia as a whole – in this issue of Business Law Magazine we concentrate on legal topics in countries and regions that are essential for Germany as one of the export champions of the world. Don`t miss what our authors have to say about legal milestones and lessons for foreign investors and arbitrators.

As always you will find in-depth articles on German corporate law and M&A. In this issue we particularly take the shareholder`s position into account.

In addition to this we also focus on the latest developments with regard to German patent, licensing and insolvency law. So there is quite a bit of new information you need to know – enjoy reading!

Yours sincerely,

Thomas Wegerich

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A silver lining on the horizon: Brazil and its new legal milestones every investor needs to know

By Dr. Claudia Bärmann Bernard

Doing business in Brazil requires comprehensive knowledge of the economic, social and especially the legal environment. Investors and companies should be aware in particular of new laws on important issues recently passed by the Brazilian legislator, considered milestone legislation in their respective areas of law. With this article, we want to provide the reader with a short overview on these new laws that are expected to have an impact on investors and companies doing business in Brazil.

Overview on the economic situation in Brazil

After years of economic growth and social development, Brazil is finding itself right now in an economic and political crisis, facing not only declining rates of economic growth, but contraction in 2015, a weak national currency, increasing inflation and interest rates, shrinking private consumption and a rising unemployment rate. The country and its government are further being challenged by the uncovered corruption scandals involving public oil company Petrobras and several construction companies.

Still, companies continue to invest in Brazil and our Chamber receives numerous inquiries to assist German companies in launching their business activities in Brazil while only very few companies are considering quitting their activities.

This scenario can be explained by two factors.

On one hand, regardless of its current situation, Brazil is a nation with immense potential for foreign investors. Brazil is the largest economy in Latin America and ranks as the seventh-largest economy worldwide. The country has vast natural resources and a large and diversified economy. With its over 200 million inhabitants, it has the world´s fifth-largest population representing nearly 3% of global consumers.

On the other hand, as Albert Einstein once said, in the middle of difficulty lies opportunity. M&A transactions are expected to grow and offer opportunities for German companies to enter the market and establish local presence, which in turn can improve competitiveness regarding participation in public tenders as well as regarding the fulfillment of local content requirements for several industries, including the automotive industry and gas & oil business.

Brazil needs investments especially in infrastructure, the health and education sector. Further, the energy sector and renewable energy sources, environmental technologies, agricultural and food industries as well as services in the information and communication technology have a particular growth potential.

Overview of recent legal milestones

Changes in the Brazilian Code of Civil Procedure (Código de Processo Civil) and the Brazilian Arbitration Act

Brazil´s current judicial system is very bureaucratic and emphasizes procedure, making judgments very slow, uncertain and costly and consequently creates uncertainty and hesitation among investors when it comes to enforcing claims in court. Guided by the awareness that an inefficient procedural system leads to a lack of real effectiveness of the legal system, the new Code of Civil Procedure, Law n. 13.105/2015 comes into effect on March 17, 2016, after one year of vacatio legis, revoking the current Code of Civil Procedure, Law n.5.869/1973.

The new law is expected to provide a cohesive and systematic legal framework with adequate procedural rules including new mechanisms for enforcing material rights. Simplified defense rules, unification of appeal time limits and changes in the method of calculating filing dates and other deadlines are designed to accelerate and simplify court proceedings.

Alternative methods of dispute resolution such as arbitration, conciliation and mediation have been given special focus.

The new Code of Civil Procedure determines the judge´s obligation to promote conciliation →

hearings. In addition, the courts shall establish centers for consensual dispute resolution.

The Brazilian Arbitration Law was also subject to amendments. Especially, the scope of applicability to direct and indirect administration was widened and courts were enabled to issue provisional measures before the initiation of arbitration proceedings.

Furthermore, at the end of 2015, the Brazilian Mediation Law comes into effect, regulating judicial and extrajudicial mediation proceedings. The benefits of alternative dispute resolutions under moving and complex markets are obvious: speed, flexibility, confidentiality, and expertise. The German Brazilian Chamber of Commerce offers alternative dispute resolution through the Eurochamber´s Mediation and Arbitration Chamber (CAE). Further information is available on our website, www.ahkbrasil.com.

Labor law and outsourcing

One major challenge foreign investors are facing in Brazil is the employee-protecting labor law and respective jurisprudence. Further detriments in the context of Brazilian labor law are high non-wage labor costs and risks in outsourcing due to joint liability for claims of employees hired by the contracted third party. A proposed bill, Law 4.330, is expected to bring more certainty in outsourcing contracts and increase competitiveness but it also faces resistance by unions who fear negative impacts on workers' rights and working conditions.

The bill proposal was passed by the Chamber of Deputies in the National Congress and directed to the Senate for approval. According to Brazil´s current labor legislation (the so-called Consolidação das Leis Trabalhistas), outsourcing is only permitted to fulfill non-core activities, like security, janitor and cleaning services, while core-activities cannot be outsourced. The new law allows outsourcing in any field of work and would apply to private companies, freelancers and agricultural producers.

Nonetheless, even under the new law, the contracting company has to implement appropriate supervisory measures to make sure the contractor meets its labor, tax and social security related obligations in order to avoid joint liability and limit his responsibility to a subsidiary liability.

Anti-corruption law

Mismanagement in the Brazilian economy gained international attention by the Petrobras' massive corruption scandal. This scandal, popularly known as "Petrolão", not only had negative consequences on the image of Petrobras, but is also a setback for Brazil as a business location.

Corruption in general bears several threats to an economy because it derogates competition, increases market prices and leads to a lack of confidence in the market. Considered a milestone legal framework, the Brazilian Anti-corruption Law entered into force on January 29, 2014.

The law establishes strict civil and administrative liability of legal entities for acts of corruption against national or foreign public authorities. For sanctions to be applicable, no proof of negligence or willful (in) action is necessary. Further, the company is liable even if it does not benefit from the illicit acts determined by the law. Parent companies, subsidiaries, other affiliates and consortiums are jointly liable for payment of fines. The personal liability of individuals arising from criminal or civil law is not eliminated by the provisions of this law.

Penalties range from (a) publication of the condemnatory decision in the local press , (b) applicable fines in the amount of up to 20% of gross revenue, never being lower though, than the advantage obtained, up to the amount of BRL 60,000,000, (c) partial suspension or interdiction of activities, (d) loss of assets, (e) compulsory dissolution of the legal entity and (f) a ban on participating in public tenders and receiving incentives, subsidies and grants from public entities for the duration of one to five years.

Companies in violation of the law may enter into a leniency agreement at any time up to the completion of the investigative process if meeting certain requirements of cooperation, in order to reduce the sanctions that may be imposed.

It is further important to mention that the new anti-corruption law encourages the effective implementation of compliance programs, with application of codes of ethic and conduct and the existence of mechanisms and internal procedures of integrity, auditing and incentives to report irregularities. The existence of these mechanisms will be taken into account by the government when applying the administrative sanctions.

Internet law

Another fundamental new legislation provides an extensive set of rules to organize internet use in Brazil. The so-called "Marco Civil da Internet" entered into force in June 2014 and establishes key principles, rights and duties. Freedom of speech, privacy and data protection, network neutrality as well as network stability, safety and functionality and preservation of the participative nature of the web are some of the key principles established by the law. According to the network neutrality principle, internet service providers have to treat all data on the internet equally irrespectively of content, user, site, application, service and so on.

Personal data as well as access and connection records may only be communicated, collected, used, stored and processed with the express consent of the internet user or in exceptional cases as determined by the law. The internet law also provides the right to be forgotten, the right for internet users to have their personal data deleted at the end of contractual relations. The Brazilian law applies to any collection, storage and processing of personal data or communications if at least one of these acts take place in Brazil or one of the terminals is located in Brazil. Foreign companies have to comply with the law if the corporate group has a local entity in Brazil or if services are offered to the Brazilian public.

In any case, the use of the internet in Brazil shall promote the right of access to the internet for all, the access to information, knowledge and participation in cultural life and public issues. It shall further promote innovation and dissemination of new technologies, new use and access models as well as open technical standards that allow communication, accessibility and interoperability between applications and databases.

For additional information on economic and legal aspects of doing business in Brazil, the AHK São Paulo provides a broad range of publications and studies. <–

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Editor's note:
For further information please got to www.ahkbrasil.com. The author wishes to say thank you to Sebastian Rünz, LL.M. (Toronto), a German trainee lawyer who currently works at the German Chamber of Commerce in São Paulo.

The heat is on!

Update on shareholder activism in Germany

By Dr. Markus Nauheim, LL.M. (Duke)

The summer of 2015 in Germany has been one of the hottest of all time. While the temperatures are cooling down heading into the fall, the heat from another powerful source exacted on German public company executives will likely persist, and may even rise. A new breed of bigger and bolder activist shareholders has emerged and is increasingly targeting corporate Germany.

Over the course of the past 12 months, Swedish activist fund, Cevian Capital, for example, managed to secure seats on the supervisory boards of ThyssenKrupp and Bilfinger, respectively. In Bilfinger's case, even the CEO was removed and the chairman of the supervisory board replaced by Cevian partner and former Metro CEO, Eckhard Cordes. Other recent examples include the (reported) campaigns by US and UK activist funds Third Point, Knight Vinke and TCI against Adidas, Dutch hedge fund PGGM against GSW Immobilien and US hedge fund Elliott's engagements in the realms of Celesio, Kabel Deutschland, DMG Mori Seiki, Schuler and Medion.

Shareholder activism has reached a new dimension

Shareholder activism has been a common phenomenon in Germany for decades and comes in many different shapes and sizes. On the one side of the spectrum are the modest institutional investors and minority shareholder associations, while the other one sees the aggressive predatory shareholders, professional plaintiffs and activist hedge funds. The common opinion had been pretty clear with respect to the latter group of activists: corporations need to be protected from those activists that would seek short-term profits at the expense of a company's long-term value. However, there has been a change of paradigm when it comes to the perception and acceptance of activist hedge funds. Some of the recent activist campaigns in Germany were not only welcomed, but actively supported by major institutional investors and proxy advisors that gave the activist funds much more influence than their positions in the targets suggested. Certain activist hedge funds seem to have re-branded themselves from raiders to rescuers.

Activist funds do not want to speculate about future performance, they want to impact it.

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The heat is on and boards of German public companies can no longer ignore activist funds. Activist funds do not want to speculate about future performance, they want to impact future performance and they are growing massively both in size and number. Between 1999 and 2011, 253 potential activist campaigns at 140 publicly-listed companies were counted in Germany. In 2014, 257 companies were targeted by activists in the United States alone. And as of June 2015, 519 activist →

hedge funds were said to collectively manage over US$140 billion in assets. The pressure to put this capital to work quickly is tremendous as the campaigns tend to get larger and larger, making one thing quite obvious: activism is here to stay and will most likely become the new normal.

Different categories of activist funds and their objectives

There are several categories of activist funds. Firstly, there are the well-established US mid- and large-cap activists who have become household names (such as Paul Singer of Elliott Management, Carl Icahn of Icahn Associates, Daniel Loeb of Third Point, Nelson Peltz of Trian and Bill Ackman of Pershing Square), a group where size seemingly does not matter, as recently demonstrated by Pershing Square's US$5.5 billion position in US foods company Mondelez or Icahn's stake in Apple, estimated at a value of over US$6 billion. They keep pursuing larger and larger companies and each one of them is capable of moving the stock price simply by disclosing the fact that they have taken a position. Secondly, there are the small and mid-cap activists who tend to be the most active in terms of number of campaigns and who are often multi-strategy funds (such as Starboard Value or Clinton Group). Next, there are the sector specialists that are very targeted in their focus, and lastly, the (relatively) new activist funds that are being launched constantly in the U.S. and internationally, some of them coming out of established activist funds, pushing aggressively to build their track records (including the likes of Corvex Management, Marcato and Cevian Capital).

Activist hedge funds need to generate significant, what modern portfolio theory calls "alpha" (that is, risk-adjusted excess returns) for their investors. Although their recent tactics of impacting their targets' business decisions are reminiscent of the strategies used by private equity investors, activist funds are not interested in taking over and running companies on a daily basis. Activist funds as a group have generally outperformed the market. However, neither all activist funds nor all of their campaigns are successful. Activist funds that made headlines in the German market in the past (such as Atticus in connection with Deutsche Börse or PGGM in connection with GSW Immobilien) have shut down in the interim. Thus, when confronted with an activist campaign, the target's management needs to be aware that activist funds pursue strategies with volatile outcomes that should put some of the activist's demands in perspective.

Who is vulnerable to activist attacks?

Activist funds usually look for a range of particular weaknesses, for example (a) the target has underperformed relative to its peers or the market, (b) the capital structure is such that the target either has large cash reserves or is under-leveraged, (c) the target has the potential to divest or spin off one or more of its business units or assets, including real estate, (d) there is a widely spread and susceptible shareholder base, (e) the target is perceived to have no clear strategy, and comments by analysts and the press have been negative, (f) there is a weak management and/or supervisory board, (g) the target has serious corporate governance issues and (h) there is a low presence at general shareholders' meetings.

Resulting from those perceived weaknesses, common activist demands include pushing for (a) a return of capital either through dividends or share buybacks, (b) asset sales and spin-offs, (c) the removal of weak or renitent members of the management and/or supervisory board, (d) a change of the capital structure (debt equity ratio), (e) a reform of the target's corporate governance and (f) the implementation of cost cutting measures, including the reduction of executive compensation.

The activist fund's toolkit

Activist funds do not solely play by the playbook prescribed by the German corporate and securities laws that offer only limited minority shareholder rights and means. Instead, they use a broad and sometimes unconventional set of tools that many German companies are not familiar, and tend to struggle, with. They contact investor relations departments as part of their background diligence and information gathering. They call, demand one-on-one meetings with, and/or write private letters or emails to, individual members of the management and/or supervisory board to articulate their requests, engage in a discussion and gain valuable insights. Either as part of the mandatory disclosure process or by way of press releases, activist funds publicly disclose their positions. At the latest when they reach or exceed the 10% threshold for a substantial interest, activist funds also (have to) disclose the strategic objectives they are pursuing →

and whether they intend to change the composition of the boards and the target's capital structure. In many instances, they will also use other forms of public communication, including the general press, social media or websites especially set up for the specific campaign. Activists in many cases prepare and sometimes publicly disclose very detailed and well-researched white papers setting forth the target's weaknesses and the activist's criticism and proposals.

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Companies need to monitor and regularly analyze their existing shareholder base.

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One thing should be vividly clear, and that is that these measures are generally not aimed at convincing the target's management of the changes that are warranted according to the activist. The activist's main objective is to convince and gain the support of co-shareholders and their proxy advisors. While it is difficult, and sometimes impossible, to identify other co-shareholders under German law, activist funds have found ways of overcoming this obstacle. International activists have become very sophisticated and are well-familiar with applicable laws in Germany, including the rules governing acting in concert and how to avoid the attribution of voting rights that could trigger disclosure requirements, the (temporary) loss of voting or dividend rights when violating such disclosure requirements or the obligation of making a mandatory takeover offer.

What should German corporations do?

Firstly, act, don't react. Many of the strategies proposed by experts focus solely on the response to an attack and the preparation thereof. This alone, however, is too short-sighted. In addition to the response plan, corporations should establish teams that think like and regularly take a look at the company through the eyes of an activist fund to identify weaknesses. Activist know-how needs to become an inherent part of the management's strategic and financial decision-making process. In doing so, management's main driver should not necessarily be to defend attacks by activist shareholders, but to avoid them by continuously seeking to identify and unlock hidden value.

A second important aspect is not only the effective communication internally, but also continuous dialogue with major institutional investors and proxy advisors. Management needs to keep the stakeholders informed about the management's business strategy and build or maintain their confidence in it. While activist shareholders focus on unlocking shareholder value quickly, institutional investors pursue long-term investment strategies and generally understand that management's overriding responsibility is to act in the best interests of the company, meaning the company's sustained prosperity. Generous salaries to the workforce, low dividends or a low leverage, for example, may come at the expense of the shareholders, but might be well-founded and in the best interest of the company at a given time. Management needs to make a compelling case that is regularly communicated to major institutional investors and proxy advisors. Rest assured, if management doesn't do it, the activists will.

Finally, a company needs to monitor and regularly analyze its existing shareholder base (identifying unusual trading and activist positions before public disclosure) as well as review its articles of association and corporate governance policies for best practices.

When corporations successfully integrate the above measures into their business routines, no executive should be afraid of activist funds, but actually be grateful to them for having helped to initiate a valuable reform process that benefits all. <–

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Beware of shareholder loans: protecting the seller in M&A transactions

Best practice: How to protect the seller in M&A transactions

By Dr. Steffen Schniepp and Dr. Christian Hensel

Introduction

When it comes to the financing of companies, shareholder loans are of outstanding importance whether for mid-tier companies, (inter)national groups or venture capital or private equity investors. When companies financed by shareholder loans are sold the seller does not usually wish to continue his financial engagement. By the same token, the purchaser regularly wishes to end any kind of financial dependence between the target company and the seller. Taking account of these interests, share purchase agreements have, up until now, usually provided for the sale and assignment of shareholder loans together with the shares in the target company. Since 2013, there has been a great discussion about whether or not this approach can remain standard procedure.

Background

According to s. 135 ss. 1 no. 2 German Insolvency Act (*Insolvenzordnung – InsO*) any payments on shareholder loans (principle amount and interest) can be contested by the insolvency administrator if insolvency proceedings are opened over the assets of the company within one year after payment. In 2013, the German Federal Court of Justice (*Bundesgerichtshof*, or *BGH*) decided that if a shareholder loan is assigned and repaid after assignment not only the assignee but also the assignor is liable (as joint and several debtor) for restitution pursuant to s. 135 ss. 1 no. 2 InsO. That effectively means that the assignor has to repay funds it has never received. Clearly, the underlying case demonstrated strong signs of collusion. However, the BGH emphasized that collusion was not proven and not required to order the assignor to repay the full amount of the shareholder loan.

When companies financed by shareholder loans are sold the seller does not usually wish to continue his financial engagement.

There are grounds for rejecting this judgment. It is, for instance, doubtful whether s. 135 ss. 1 no. 2 InsO provides a basis for a claim against the assignor although the assignor never received a payment. Quite the contrary: s. 143 ss. 1 InsO expressly states that assets received by virtue of the contested transaction have to be returned, meaning that someone who did not receive anything cannot be obliged to return it. It is also questionable whether the insolvency administrator should benefit from a duplication of debtors just because the shareholder loan was assigned, or even multiplication of debtors, in the event of several assignments of the same loan. →

Furthermore, there are grounds to argue that this judgment should not apply to the transfer of shareholder loans in M&A transactions. In contrast to the case decided by the BGH, the assignment of shareholder loans is, in M&A constellations, a mere annex to the sale and transfer of shares. The seller loses its position as shareholder and, in consequence, his responsibility for the fate of the company (*Finanzierungsfolgenverantwortung*).

Nevertheless, as long as there is no deviating judgment by the BGH, the seller is well advised to insist on contractual protection against repayment claims asserted by a potential insolvency administrator.

Protecting the seller

The M&A practice has, in essence, found two ways of shielding the seller from claims pursuant to s. 135 ss. 1 no. 2 InsO. One option is to sell the shareholder loan but to include clauses in the sale and purchase agreement dealing with potential claims by the insolvency administrator. The other option is not to sell the loan and instead provide for an economically equivalent solution.

Clauses shielding the seller from risks

If option one is chosen, there are several ways to protect the seller: (a) a binding letter of comfort by the purchaser, (b) an indemnity against claims by a potential insolvency administrator and (c) an obligation by the purchaser not to collect the shareholder loan for (at least) one year after closing. As outlined as follows, these solutions feature different advantages and disadvantages.

A binding letter of comfort avoids (as long as the purchaser is solvent, see below) the insolvency of the target company and, hence, any risk of contestation pursuant to s. 135 ss. 1 no. 2 InsO. However, the purchaser will not usually be prepared to agree to such wide-ranging obligations.

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The purchaser regularly wishes to end any kind of financial dependence between the target company and the seller.
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The indemnity is more precise. It provides the assignor with a recourse claim against the purchaser only if and to the extent the insolvency administrator actually brings claims against the assignor. If the indemnity is secured and drafted in a way that suits the sellers and the purchasers needs, for example with regard to caps and time-limitations, then the indemnity is usually a good solution to the question at hand. It is often used in practice.

However, once in a while a purchaser objects to the indemnity because it bears the risk of paying twice for the same loan: initially at closing when paying the purchase price for the loan and later, after a potential contestation, when the indemnity is invoked. The seller's argument that this will happen only if the target company falls insolvent within the rather short period of one year after closing and at a time when the company is under the sole control of the purchaser is sometimes countered. Some purchasers fear that the insolvency could be triggered by risks already set by the seller in the past that surface only after closing and without sufficient coverage by seller's guarantees.

In such situations, the obligation not to collect the loan for at least one year after closing can provide a way out. BGH-jurisdiction clearly indicates that a collection later than one year after closing excludes the risk of contestation pursuant to s. 135 ss. 1 no. 2 InsO towards the seller. At the same time, as long as the shareholder loan is not repaid, the purchaser does not run into danger of paying twice.

As a result, the secured indemnity will regularly constitute the preferred solution. Only in certain cases will the parties choose a comfort letter or a non-collection obligation.

An alternative approach

If the second option is chosen, the parties have decided against an assignment of the loan and terminate the loan prior to closing.

One possibility to achieve this aim is by repaying the loan at closing. While the repayment can be structured in different ways, the only really promising method is the direct payment of the amount of the shareholder loan by the purchaser to the seller at closing immediately after the shares have transferred to the purchaser, this repayment qualifying in between the purchaser and the company as contribution to the free capital reserves of the company and in between the purchaser and the seller as repayment of the loan. However, given that, from a civil law perspective, even in this situation →

wherein the company makes a payment to the seller, there remains a certain residual risk of contestation.

Therefore, it seems advisable to refrain from repaying the loan. Rather, before the share transfer takes effect, the seller should contribute the loan to the free capital reserves of the company immediately at closing. As a consequence, the loan lapses by way of confusion of rights (*Konfusion*). At the same time, the share purchase price increases because the financial debt that is to be discounted from the share purchase price according to the usual cash-free / debt-free formulas is reduced. The contribution therefore regularly constitutes an economically neutral and rather elegant possibility to eliminate the risk of contestation. The only material downside: the contribution is, generally speaking, tax-neutral only if the contributed loan is fully recoverable (*werthaltig*).

Conclusion

It is open to discussion whether the BGH-jurisdiction regarding the contestation of payments on assigned shareholder loans also applies to assignments in the course of M&A transactions. As is often the case, legal certainty will be achieved only once this question has been finally answered by court judgment. Until then, the seller will have to contractually protect himself against potential risks. The rule of thumb is: if the shareholder loan is fully recoverable the seller should contribute the loan to the capital reserves of the target company at closing in exchange for an accordingly increased share purchase price. If the shareholder loan is not fully recoverable the seller should seek protection by a secured indemnity or at least a secured obligation of the purchaser not to collect the loan within one year after closing. ←

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Standard-essential patent holders face new challenges in Europe

A milestone decision: the Court of Justice of the European Union sets new rules for negotiating license agreements under FRAND-terms

By Dr. Markus Gampp

For many years, courts all around the world were faced with the question as to if and when a proprietor of a standard-essential patent (SEP) is considered to be abusing his dominant position in filing an action seeking to prohibit the sales of a product or service because of an alleged infringement of his SEP. In that context, the question arises as to the actual measures the SEP proprietor and/or the alleged infringer must undertake in order to achieve a license agreement under fair, reasonable and non-discriminatory (FRAND) terms. In Europe, in particular the German courts took quite an SEP proprietor-friendly perspective, whereas the European Commission's recent position tended to favor an alleged SEP infringer.

On July 16, 2015, in a landmark decision (Huawei v. ZTE, case no. C-170/13), the Court of Justice of the European Union (CJEU) decided that it is primarily for the SEP proprietor to initiate license negotiations with the alleged infringer and to seek the conclusion of a license agreement under FRAND terms before resorting to litigation. On the other hand, it is not sufficient for the alleged infringer only to show "willingness" to conclude such an agreement (a point seen as the primary criterion by the European Commission). It is rather necessary that the alleged infringer also actively works towards concluding such an agreement after receiving the license offer from the SEP proprietor. Only after the SEP proprietor's efforts to conclude a license agreement have failed, the SEP proprietor will not abuse his dominant position in filing a court action seeking the prohibition of the sales of the infringing products or services.

Background: patents as abuse of market power

Standard-essential patents (SEP) are patents essential for implementing a specific industry standard (such as LTE or UMTS for mobile communication, for example) that is mandatorily defined by a standards setting body. It is not possible to manufacture products that comply with a certain standard without making use of the technologies covered by these patents. As manufacturers must therefore rely on the licensed use of these patents, companies owning such SEPs possess significant market power. This market power gives cause for concern from an antitrust perspective if the SEP proprietor uses his market power to monopolize the market or to claim exaggerated royalties. An SEP proprietor is therefore basically required to conclude a license agreement under FRAND terms. Hence, seeking a prohibitory injunction in court is impermissible, as long as the manufacturer is willing to conclude such a FRAND license agreement. →

Huawei v. ZTE: The CJEU judgement provides new rules for asserting standard-essential patents in Europe.

Even on this basis, the specific approaches on which party to burden with the obligation of making a licensing offer and the corresponding rights and obligations that are associated with them differed significantly across European courts and institutions. The German patent infringement courts, having produced the bulk of European case law on these questions in recent years, made it relatively easy for the SEP proprietor. In order to avoid an injunction, German case law has compelled the alleged infringer to initiate license negotiations by requiring the alleged infringer to send a complete offer for a license agreement to the SEP proprietor, and to comply with all terms of the license even before the conclusion of the agreement. Therefore, the licensee was already required to pay the royalties and lost the right to defend against the alleged infringement.

Contrarily, according to two decisions following investigations undertaken against Motorola and Samsung in 2014, the European Commission found it sufficient that the alleged infringer merely demonstrate his "willingness" to conclude a license agreement. Therefore, according to the European Commission, no actions need to be taken, especially no license offer made by the alleged infringer. Such a position arguably opened the door for stalling tactics and made it difficult for the SEP proprietor to enforce his rights.

CJEU: balancing interests

Attempting to find middle ground between these two points of view, the CJEU held that the SEP proprietor should be in a better position to make a reasonable and complete license offer than the alleged infringer, containing all necessary terms and a realistic royalty. Further, as the alleged infringer may not be aware of the usage of an SEP (normally, a massive amount of patents are claimed to be essential to a certain industry standard), as a very first step, the SEP proprietor needs to notify the alleged infringer about the claimed usage of his patent. If the alleged infringer is thereupon willing to conclude a FRAND license agreement, the SEP proprietor will be obliged to send a license offer to the alleged infringer containing all the terms necessary for concluding a license agreement, especially containing the royalty and the manner of their calculation.

The alleged infringer then has to respond to that offer in a diligent manner without any tactical delay and in good faith. If the alleged infringer does not want to accept the SEP proprietor's offer, he is then obliged to make a counter-offer. Normally, the amount of the royalty is highly disputed between the parties. However, making a counter-offer implicates financial risks to a certain extent for the alleged infringer. That is, if the alleged infringer still uses or wants to use the teaching of the SEP, the alleged infringer has to provide an appropriate security for that usage in case the SEP proprietor rejects the counter-offer. The security can be provided in the form of a bank guarantee, or by placing the necessary amounts on deposit.

The decision does achieve a balance between maintaining free competition on the one hand and the requirement of safeguarding the proprietor's intellectual property rights on the other.

If the counter-offer is not acceptable to the SEP proprietor, the parties may agree to have the amount of the royalty determined by an independent third party. Only if the alleged infringer does not respond to the SEP proprietor's offer in a diligent manner or if an agreement cannot be reached even after the alleged infringer's counter-offer is made, the SEP proprietor will not be abusing his dominant position in thereafter seeking an injunction in court prohibiting the sales of the products or services in dispute.

Notably, however, the alleged infringer may still defend against the alleged infringement, even after the conclusion of such an agreement. Consequently he may still defend against the usage of the patent, contest the essentiality of the patent or bring an invalidity attack against the patent. In that context, the CJEU pointed out that these rights are essential because of the right to effective judicial protection.

On the basis of this procedure, the decision does in fact achieve a balance between maintaining free competition on the one hand and the requirement of safeguarding the proprietor's intellectual property rights on the other. This guiding principle was also expressed in the CJEU's final conclusion. The court held that the SEP proprietor is free to bring an action for infringement seeking (only) the rendering of accounts in relation to or damages with respect to past acts of use. Both claims, as they relate to facts already concluded in the past, do not have a direct impact →

on products appearing or remaining on the market, either currently or in future. Therefore, the SEP proprietor is not abusing his dominant position in seeking compensation for past acts of use. From a strategic perspective, SEP proprietors may take advantage of this distinction by bringing an action for damages in court immediately, while at the same time making an offer under the procedure set out by the CJEU. If the negotiations fail, the suit can be extended by bringing an injunction claim.

Remaining issues

The CJEU decision deviates considerably from recent German case law as well as from the position of the European Commission. It is therefore left to the national courts to adapt their views in order to harmonize European case law on the basis of the CJEU's guidance.

All that being said, there is still considerable room left for interpretation, as the CJEU did not answer all the questions arising in this context. First of all, the CJEU did not decide whether an SEP proprietor always has a dominant position according to antitrust law solely due to having a patent claimed as essential to a certain industry standard. Further, the CJEU did not give any indications as to when specifically an alleged infringer demonstrates or has demonstrated "willingness" to conclude a license agreement. This question was already left open by the two recent European Commission decisions. Finally, the CJEU also did not outline the requirements for a "diligent" response from the alleged infringer to the SEP proprietor's offer. Thus it is now left to the national courts to develop guidelines whereon this "willingness" and the diligent response can be determined.

Nevertheless, the CJEU's decision does constitute a crucial milestone on the path to achieving a uniform European case law on this issue and providing much needed legal certainty at this commercially highly relevant intersection of patent and antitrust laws. ←

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The topic is still hot – waiting for the Federal Supreme Court

Germany: Recent case law on cross-licenses and insolvency law – Sec. 103 InsO as a risk for the use of necessary technologies

By Dr. Claudia Milbradt und Florian Reiling

The handling of IP-licenses in an insolvency of the licensor still is one of the hot topics of German IP-law. At a first glance, this subject merely seems to be a question of bankruptcy and insolvency law. However, the topic also touches on IP-matters as the insolvency of the licensor can have a significant impact on the business of the licensee having in-licensed IP-rights that are necessary to run the licensee's business. This article gives an overview of the current situation in Germany and outlines the framework of potential legal solutions.

Introduction

The question of whether IP-licenses are stable in an insolvency scenario has been one of the hot topics of German IP-law for quite some time. At a first glance, this subject merely seems to be a question of bankruptcy and insolvency law. However, as many companies deal with commercial products including IP-rights that are in-licensed by a third party, the insolvency of the licensor can have a significant impact on the business operations of the licensee. This is particularly true if the company undertakes costly and time-consuming efforts to develop its products that may even require regulatory approval. As soon as the underlying technology is no longer available, the company is forced to stop using the respective IP-rights, thereby being required to discontinue the production of the products. This scenario illustrates the importance of the controversial legal issues surrounding this topic based on several judgments that German courts have recently delivered. One case is currently pending at the German Federal Supreme Court (BGH; BGH - X ZR 94/13).

Connection between license agreements and the German InsO

The underlying legal questions are covered by the German Insolvency Statute (InsO) that entered into force in 1999 and contains special stipulations as regards the performance of contracts and transactions after the opening of insolvency proceedings. Under the predecessor statute of the InsO, the so-called *Konkursordnung*, obligations resulting from a license agreement have been treated like continuing obligations under quasi lease/rent contracts and, thus, the contractual effects survived an insolvency of the licensor. The reformed law brought an end to this survival mechanism. The corresponding section →

In the "umbrella license" scenario, the licensee intends to secure his contractual right to act under the scope ("umbrella") of the in-licensed IP-rights.

literally only applies to contracts that relate to immovable goods or premises. Thus, the application as regards license agreements has been excluded and licenses have been exposed to the risk of being terminated in case of insolvency of the licensor.

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The insolvency of the licensor can have a significant impact on the business operations of the licensee.
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In 2012 the German government published a draft bill inter alia dealing with the destiny of in-licensed rights in the case of bankruptcy of the licensor. The draft bill included a newly drafted Sec. 108a InsO that addressed the issue of securing licenses in an insolvency scenario and outlined certain conditions whereunder the licensee, possibly following an adaption of the licensing terms, is allowed to make continuous use of the in licensed rights. However, in the further course of the legislative procedure, Sec. 108a InsO was struck off the list of fundamental reform issues. Accordingly, there is no specific section in the current version of the German InsO specifically addressing the problem of how to guarantee the licensee's access to the necessary IP-rights given the licensor entering into bankruptcy.

Today, license agreements are assumed to fall in the scope of the general rule of Sec. 103 InsO; this section stipulates that if a mutual contract at the moment of the opening of insolvency proceeding is "not or not completely performed" by the parties, the insolvency administrator may terminate such contract, replace the debtor and claim the other party's consideration. In case the administrator terminates the agreement, the other party shall be entitled to claims for non performance only as an insolvency creditor. This allows the administrator who chose not to perform the contract to maximize the assets for all creditors.

Typical scenarios involved

The typical illustrative scenario can be described as follows: two companies dealing with commercial products or methods including IP-rights are contracting partners and have in-licensed IP-rights on the basis of cross-license agreements. After the insolvency of one of the parties along with the initiation of the insolvency proceeding, the appointed insolvency administrator wishes to terminate the license agreement in accordance with Sec. 103 InsO. The termination of the license agreement puts the insolvency administrator in the position to better commercialize the IP rights because any "license free" IP is easier to dispose of than IP-rights that partly belong to a third party. The question of whether or not the insolvency administrator is in a position to execute his rights under Sec. 103 InsO depends on the character of the license agreement.

Licenses and not or not completely performed contracts in the sense of Sec. 103 InsO

The subject at issue is when, precisely, a license agreement is deemed to be "completely performed". What is crucial to answer this question is whether a license agreement creates a "continuing obligation" (*Dauerschuldverhältnis*) or rather a "one-off obligation".

Continuing obligations are not only typical for employment- and rent/lease agreements, but also for license agreements. Each day the license agreement is in force, the licensor is obliged to maintain and defend the IP-rights in order to further allow the licensee to use the respective IP-rights. In return, the license fee is paid, that is the obligations under the agreement are carried out continuously. Accordingly, the obligations under such contracts cannot be qualified as being "completely performed".

However, this is just half the story. License agreements can also be regarded as an "on-off performance" rather than constituting a "continuing obligation". If one takes the example of an exclusive license scenario, it is common sense that not only a simple contractual right to use is granted, but rather a "right in rem" (*absolutes Recht*) that is assigned from the licensor to the licensee. In such cases it might be argued that by assigning the right to the licensee the license agreement is "completely performed", that is, the obligations under the agreement have been carried out comprehensively with the consequence that Sec. 103 InsO would not be applicable. However, even if an exclusive license is given there might be other ongoing obligations, such as an ongoing cooperation of the parties as regards the enforcement of the licensed rights, the payment of the patents maintenance fees and existing information obligations. The following examples shall help to shed light on the question of when a license agreement is to be seen as being "completely performed"

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Regional Court of Munich (LG München, 7 O 11811/12)

In August 2014, the Regional Court of Munich decided a case on a so-called "freedom to operate" (FTO)-license in the form of a cross-license. The court looked at a license agreement that granted unlimited rights to use the jointly developed technology for an indefinite period of time.

The court stated that the freedom to operate protection granted under the agreement constitutes the main interest of the parties and not the contractual right to make use of the IP-rights. The court further stressed that neither the validity of the IP-rights nor the qualification of the usage rights as contractual rights or "rights in rem" is of high importance to the parties; the core concern of the parties is rather the factual possibility to operate their business and thereby the protection offered by the FTO-license. Consequently, once the licenses are granted and the consideration (a back-license in the form of a cross-license or a payment) is performed, all contractual obligations are executed and, thus, the contract is "completely performed". As a result, Sec. 103 InsO is not applicable and the granted licenses do not become part of the insolvency estate. The court further differentiated between FTO licenses on the one hand and so called "umbrella licenses" (*Schutzschirmlizenzverträge*) creating continuing obligations on the other hand. In the scenario of an "umbrella license" the licensee intends to secure his contractual right to act under the scope ("umbrella") of the in licensed IP-rights and to make profit from the legal exclusivity it provides. Hence, ongoing contractual obligations exist that allow an application of Sec. 103 InsO.

Higher Regional Court of Munich (OLG München, 6 U 541/12)

In this particular case that is currently pending at the BGH, the two license parties founded a third company (that became finally insolvent) that both cross-licensed respectively transferred existing and future patent rights. It was agreed that the original patent owners should maintain an irrevocable, non-exclusive, timely and geographically unrestricted right to use.

According to the Higher Regional Court of Munich, this scenario cannot be described as a transfer of the entire right combined with a back-license; →

it should rather be treated as a partial assignment in the sense of Sec. 15 para. 1 sent. 2 German Patent Code (PatG). Thus, the licenses to the patent rights in question never became part of the insolvency estate, and hence, Sec. 103 InsO does not apply in such a scenario. In addition, the court stated that even if the patent rights had not been assigned and licensed back on a non-exclusive basis, the license agreement would still qualify as a "completely performed" agreement since an irrevocable license was granted and the licensor thereby renounced his exclusive rights as patent owner following from Sec 9 PatG. Once the usage rights irreversibly become part of the licensee's assets no further obligations vis-a-vis the licensor remain with the licensee. Accordingly, a "completely performed" license agreement in the sense of Sec. 103 InsO is given.

Outlook and solutions

To date, the German Federal Supreme Court has not delivered a decision explicitly dealing with the widely assumed applicability of Sec. 103 InsO to license agreements. The recent court decisions, however, have helped to better understand the concept of Sec. 103 InsO in the context of license agreement scenarios. Nevertheless, certain aspects of the discussion still remain untouched. It is expected that in its awaited decision the BGH will hopefully cover the still open matters and will also make a general statement with respect to the relation of Sec. 103 InsO and IP-licenses. Until then, the existing case law has to be considered before entering into IP-(cross-) license agreements. The following strategic considerations and practical solutions may help to work-around the currently unsatisfying legal situation:

- **IP Holding Entity:** One possible solution could be the establishment of a trust structure. The license (including the option to purchase a "right in rem") is held by a trustee who then licenses the right to the licensee. It has not yet been clarified whether such structure would "survive" the insolvency of the licensor as an insolvency practitioner might argue that the trust structure violates Sec. 119 InsO establishing that any agreement limiting the insolvency practitioner's rights resulting from Sec. 103 to Sec. 118 InsO shall be void.

- **Usufruct Agreement:** Against this background, parties involved in a comparable scenario should consider entering into a usufruct agreement as regards the in licensed IP-rights. In case of insolvency where the contractual rights to use no longer exist, the licensee may choose to activate his similar rights to the in-licensed IP under the usufruct agreement. However, the parties should pay attention to the wording of the triggering clause of the usufruct agreement. In case the usufruct is activated by the mere fact of bankruptcy of the licensor such construction may again be seen as a work-around of the regulations in Sec. 103 to Sec. 118 InsO and may, therefore, be void. <–

Key issues:

- As soon as a company deals with commercial products depending on IP-rights that are in-licensed by a third party, the insolvency of the licensor can have a huge impact on the business of the licensee. As an ultimate consequence, the company may be forced to stop its entire business activity.

- German law does not provide for explicit legal provisions addressing the issue of how and when license agreements might be terminated in an insolvency scenario. There are only general provisions and, therefore, legal uncertainty as regards different legal constructions like cross-, FTO- or umbrella licenses and partial assignments or assignments including back-licenses.

- A potential landmark decision of the German Federal Supreme Court is currently awaited. Interim solutions to protect the licensee in case of an insolvency of the licensor might be the establishment of a trust structure (IP holding entity) or by entering in a usufruct agreement to be able to use the IP-rights on an "in rem"-basis.

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Navigating India: lessons for foreign investors

No longer a step into the dark, but learning from the past is essential for a successful business in the future

By Nandan Nelivigi and Dr. Markus Burianski

The challenges of doing business in India are well-documented. In the World Bank's 2015 "Ease of Doing Business" index, India placed 142nd out of 189 countries. It ranked 156th on ease of paying taxes and fell almost to the bottom of the list on ease of enforcing contracts. Fortunately, investing in India today is no longer a step into the dark. Many multinationals have invested in India over the past two decades, and their experiences—good and bad—offer important lessons for companies that wish to enter or expand their activities in the country. While there are no easy rules for success, we offer the following guidelines to help navigate India's complex business and regulatory landscape in the belief that those who learn from the past and strive to understand the present are most likely to succeed in the future.

Investing in India—the promise is tremendous.

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Understanding the regulatory regime

While changes to India's business laws can be frequent and sometimes unexpected, they are not arbitrary. India's laws and regulations reflect the political compromises required to balance the complex and conflicting demands of multiple constituencies. These compromises often emerge from a process of trial and error and are reflected in loosely drafted policies, clarifications, amendments and occasional policy reversals. The resulting rules can have unintended consequences, and some are so convoluted as to be impracticable. But the history of why and how these compromises were made reveals the intentions of the legislators who drafted them. This is key to navigating India's legal landscape. Companies that understand the motivations driving policies are more likely to understand how rules will be interpreted in the future—and will be better able to position themselves for success.

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India's laws reflect the political compromises required to balance the complex demands of multiple constituencies.

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India's foreign exchange regulations, for example, are not just bureaucratic hurdles. The policy rationale behind India's aversion to foreign debt stems from the 1991 foreign exchange crisis that nearly caused India to default on its foreign currency obligations. →

As a result, Indian companies can borrow in foreign currency only in accordance with very restrictive conditions while equity investments are subject to more liberal rules. Many investors, driven by commercial imperatives, made equity investments in India that were redeemable like debt obligations and subsequent regulatory pronouncements ultimately rendered these structures unenforceable. This consequence could have been avoided if the rationale— namely, debt or debt-like obligations are not favored— had informed the transaction structures.

Interpret regulations conservatively

In developed countries, with some exceptions, authorities are more likely to apply commercial laws as written, prioritizing an understanding of what the law actually states over what the lawmakers intended. In India, rules are often more loosely articulated, leaving room for authorities to account for legislative intent when the rule is applied.

Faced with regulatory ambiguities, foreign investors often rely on technical interpretations that open up attractive commercial opportunities. But even the most elegant technical solutions are vulnerable when they conflict with the lawmakers' underlying objectives, regardless of what the regulation in question explicitly states. When the economics of a deal depend on an aggressive, technical interpretation of the law, companies should think twice. In such instances, companies should hew to conservative interpretations that do not leave their business models vulnerable to later decisions by authorities.

Evaluate joint venture opportunities in forensic detail

The benefits of partnering with locals can be significant as they often understand the market and culture better than foreign firms. They usually have strong relationships with Indian authorities and other businesses, and are likely to have the necessary infrastructure in place to produce, distribute or sell products in the country. But the downside of joint ventures can also be significant, particularly if they require investors to yield too much control over their businesses. For instance, Haier, the large Chinese home appliance and electronics maker, had more success in India without a partner than it did with one. The venture came apart after it became clear that the partners had different strategic objectives and Haier subsequently reentered the market on its own.

Investors should investigate their options in granular detail to ensure they understand how potential partners operate at every level of their organizations. This includes engaging in a rigorous analysis to assess cultural fit and conducting due diligence into the background and capabilities of potential partners. Remember also that India's many family-owned businesses (which still constitute a significant portion of corporate India) often take very different approaches to running their companies compared to large foreign, independently managed, companies. Foreign companies that enter into partnerships with family-owned businesses must take care to ensure that the venture meets their operating and performance expectations, particularly in areas such as corporate governance, accounting and compliance.

Build in commercial protections

Despite the hurdles involved in enforcing contracts against counterparties in India, the importance of having carefully drafted commercial contracts cannot be overstated. Certain foreign companies may be persuaded to accept contractual arrangements in India of a lower standard than they would typically accept in developed markets. However, in our experience, when such investors find themselves in a dispute, they find that ambiguities and omissions in their contractual arrangements often severely compromise their ability to protect their rights. Here we highlight steps investors should take to build commercial protections into their dealings in India.

Create balanced and equitable contracts

In joint ventures, it is critical to ensure that each partner has meaningful skin in the game so that each is attentive to the risks and rewards of the venture. The partner with a small financial stake in the venture may be willing to take bigger risks that could lead to risky bets, delays, cost overruns and other completion risks. It is also important to ensure that benefits are allocated fairly among all participants. Agreements that disproportionately reward one partner are likely to cause conflict down the line. More generally, foreign companies can protect themselves by developing deeper relationships with domestic partners. Foreign companies that have been able to commit to a long-lasting, mutually beneficial arrangement that encourages all parties to think about more than just short-term opportunities, are the most likely to succeed in their venture with an Indian partner. Similarly, foreign

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companies that engage in multiple businesses with the same domestic partner are also likely to see enhanced chances of success.

Trust, but verify

Investors must take steps to ensure prudent measures are established at the outset of a partnership. Investors should appoint independent auditors to maintain and verify the accuracy of the venture's accounts and ensure that they comply with the law and internationally recognized accounting standards. It is also wise to secure the right to appoint and remove key officers who don't meet performance and other standards and negotiate terms that give clear approval rights for major decisions. And whenever possible, buttress contracts with collateral security. Unsecured commitments are risky by definition, and investors should be particularly diligent in vetting potential partners that cannot provide collateral.

Once a relationship is up and running, foreign investors should work closely with the management of their Indian partners. Merely securing seats on the board won't be sufficient, as most Indian boards have relatively little influence on how businesses are run.

Plan the exit and resolve disputes offshore

Planning the exit up front can enable companies to limit their losses, avoid or de-escalate disputes, and minimize disruption of business. There should be clarity on which entity will have control of the company if the joint venture is dissolved—and which partner will own each asset if the company is dissolved along with the joint venture.

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Even when Indian law is the basis of the contract, it is important to agree to settle disputes through arbitration seated outside India.

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Further, since resolving a business dispute in Indian courts can take up to a decade or more, foreign companies should make every effort to resolve conflicts through offshore arbitration or, in limited circumstances, through non-Indian courts. Even when Indian law is the basis of the contract, it is important to agree to settle disputes through arbitration seated outside India.

The difficulties faced by Enercon, the German turbine manufacturer, in its dispute with its Indian joint venture partner illustrate the challenges and the lessons. The dispute arose in 2007 reportedly on account of differences in business strategy between the partners and resulted in the German management being denied access to financial information and board meetings. It took the parties seven years just to resolve disputes about the validity of an inadequately drafted arbitration clause and to overcome interference in the dispute by Indian courts and authorities.

Conclusion

In conclusion, India's promise is tremendous. But, while the risks of investing in India may diminish as its business climate improves, most companies and investors cannot wait for that to happen. They recognize the need to act now to enter or expand their operations in the country, and, fortunately, they can mitigate the risk of doing so by implementing lessons from those that have already entered the market, whether successfully or not. Indeed, by building thriving businesses in India, foreign companies can help the country realize its potential, accelerate progress and fuel a virtuous cycle of economic and social returns. <–

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Editor's note:
The authors would like to thank Kanika Sharma, international law clerk at White & Case, for her support regarding this article. See also the article "Made in India—made by Germany" written by Bernhard Steinrücke in Business Law Magazine 3/2015, HERE. (tw)

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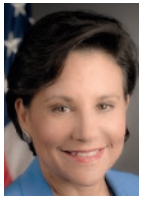

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Arbitration is becoming increasingly Asian

There are four main drivers of the process

By Dr. Nicolas Wiegand and Dr. Tom Christopher Pröstler, LL.M. (Sydney)

Introduction

The vast majority of international contracts provide that disputes arising out of or in connection to them are to be resolved by arbitration instead of litigation. This is because arbitration offers a number of decisive advantages over litigation when it comes to international transactions.

To name just a few, firstly, international arbitration forgoes any national bias or home-team-advantage associated with litigation. Secondly, arbitration is more flexible, among other things allowing the parties to choose procedural rules, arbitrators and an administering arbitral institution. Thirdly, and most importantly, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) guarantees that international arbitral awards are generally recognised and enforced all across the world. A similarly far-reaching agreement allowing the enforcement of state court judgments does not exist.

The old times...

Traditionally, the geographical centres of international arbitration were located in Europe and North America. The widely used and accepted international arbitral institutions, like the International Court of Arbitration of the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) or the International Centre for Dispute Resolution of the American Arbitration Association (ICDR), are located there. Further, cities like Paris, London, Zurich, Geneva, Frankfurt, Vienna or Washington were regularly chosen as seats of arbitrations, and still are.

...are changing

Over the past two decades, however, Asian options have increasingly added more choice to this mix. Today, Asia has firmly established its place in international arbitration, both with a number of high-profile arbitral institutions such as the Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC), or the China International Economic and Trade Arbitration Commission (CIETAC), and with seats of arbitrations in cities like Hong Kong or Singapore.

Asian arbitral institutions will often have a better understanding of Asian culture, realities and legal systems.

In fact, despite having already established its place in international arbitration, Asia is still building and expanding its presence. The main drivers of this process are the growing economic strength and geopolitical importance of Asia as well as the ever-increasing legal sophistication and infrastructure within the region. Asia's progressive development leads to growing numbers of international arbitrations involving Asian parties, while at the same time providing these →

parties with inherently stronger bargaining powers. This means that western parties are less often in a position to impose their own preferred arbitration clause, including western arbitral institutions or seats. At the same time, Asia's growing legal sophistication and infrastructure gives western parties less reason to insist on such institutions or seats.

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All across Asia, new arbitral institutions, such as the HKIAC and SIAC, have been created and existing institutions, like CIETAC or KCAB, have been modernised.
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The following case numbers give a snapshot of new international arbitration cases registered in 2013 (or in 2012, when more recent figures were not available) with some of the most prominent arbitral institutions in Asia, Europe and North America. These numbers demonstrate that while the major Asian arbitral institutions have been on the market for much shorter than most European and North American institutions, they have an annual new caseload equivalent to or even exceeding some of their most prominent western counterparts.

Arbitration in Asia: The caseload speaks for itself

The HKIAC, established in 1985, registered 195 new international arbitration cases in 2013, while the SIAC, established in 1992, registered 223 such cases. Mainland China's most traditional arbitral institution, the CIETAC, founded in 1956, recorded 311 new international cases (for 2012) and its Korean pendant, the Korean Commercial Arbitration Board (KCAB, established in 1966), registered 77 such cases. In Europe, the LCIA, dating back to 1883, had a total of 290 new cases, including a number of purely domestic cases. The SCC, established in 1917, had 86 new international cases and the German Institute of Arbitration (DIS), with its roots dating back to 1920, recorded 30 (2012). The ICDR, as the dominant North American institution dating back to 1926, had a total of 1165 new international cases. Finally, the ICC, as the most international arbitral institution and established in 1923, registered 767 new international arbitration cases. Notably, this number includes cases filed with the ICC's main office in Paris and its branch office in New York, but in particular also a substantial number of new cases filed at the ICC's Asia office in Hong Kong.

Now, while it is easy to understand why Asian parties should welcome the trend to more international arbitration in Asia, it is less obvious why western parties should also welcome it. However, there are multiple reasons for this.

The traditionally high-frequented arbitral institutions in Europe and North America are selected for their professional and efficient case administration and support services, as well as for their modern, precise and exhaustive arbitration rules. Similarly, the cities in Europe and North America regularly chosen as seats of arbitrations offer high-quality infrastructure such as good international and local transportation, as well as hotels and conferencing facilities. More importantly, these seats provide first class legal background for international arbitration with up-to-date, well balanced national arbitration laws and sophisticated, well qualified and independent state courts ready to safeguard and support the fair and effective conduct of arbitral proceedings.

High quality arbitration laws

In the past, it was not easy to find similar conditions in other parts of the world. This has changed. With the economic rise and modernization of many Asian countries came the need for legal and judicial reform. In terms of international arbitration, this led to the introduction of new or modernized arbitration laws adapting international standards. Today, all major Asian states are members of the New York Convention safeguarding the enforceability of international arbitral awards in the other member states, and many have adopted the UNCITRAL Model Law on International Commercial Arbitration, a second key United Nations tool promoting congruent worldwide legal standards for international arbitration. The modern national arbitration laws are supplemented by generally arbitration friendly and highly specialized independent state courts that, particularly at seats such as Hong Kong, are famous for ensuring the effective conduct and integrity of arbitral proceedings.

Moreover, all across Asia, new arbitral institutions such as the HKIAC and SIAC, have been created and existing institutions, like CIETAC or KCAB, have been modernized. These institutions today provide services at the same level and quality as European and North American institutions. In addition, the ICC established an Asia office in Hong Kong in 2008 to administer its Asian related →

arbitration cases. Further, the arbitration rules of Asian institutions are being updated on a very regular basis (and in fact more frequently than the rules of established European arbitration institutions) and are of the same quality as their western counterparts, if not better. In some aspects, they have taken the lead on international innovation.

Finally, the growing economic strength and legal sophistication of Asian countries has drawn virtually all major international law firms to the region and promoted the international expertise of Asian firms. The infrastructure for arbitration is often immaculate. For anyone who has arrived at one of Asia's main airports, travelled on its major cities' subway systems or stayed in one of its countless high-class hotels knows that Asian cities easily match if not surpass European and North American metropolises.

It follows that the traditional reasons for choosing arbitral institutions and seats in western countries have lost their merit. Today, first-class arbitral institutions, seats and law firms can be found not only in Europe and in North America, but also in Asia. For the users of international arbitration, independently of whether they come from the west or the east, this is good news, as it allows them a greater choice and flexibility when selecting the optimal arbitration arrangement to suit their transactions.

Convergence of civil and common law in arbitration practice in Asia

Nevertheless, some distinctive features of arbitration in Asia remain. Maybe the most intriguing of these is that the two central, most developed arbitration hubs of the region, Hong Kong and Singapore, are both common law jurisdictions, while the surrounding powerhouses of the Asian economy, like Mainland China, South Korea or Japan, are civil law jurisdictions. The same is true for the most important rising economies in South East Asia. This leads to the unusual consequence that many lawyers providing arbitral services to the Asian market from Hong Kong and Singapore have a common law background, while the parties to the dispute come from civil law countries. In the worst case, this may lead to considerable frictions and misunderstandings between lawyers and clients (and possibly the tribunal) and a discrepancy between what the parties expect and what they get from arbitration.

In the old arbitration hubs of Europe, and to a lesser degree in those of North America, similar collisions between civil and common law have resulted in major arbitral law firms hiring a diverse mixture of lawyers from different legal backgrounds in order to optimally meet their clients' and the specific case's needs. This process has also begun in Asia, with the more common law dominated firms in Hong Kong and Singapore starting to integrate more civil law educated lawyers in their ranks. For the same reason, CMS' arbitration group decided to service Hong Kong, and from here Asia as whole, with a team educated both in civil and common law, but with a focus on the former in particular with a view to the enormous market of Mainland China, a civil law country, on the doorsteps of Hong Kong. Thereby, CMS not only distinguishes itself from other firms and adds to the diversity of the Hong Kong legal market, but is in particular also able to provide tailored advice for both Asian and European civil law clients on arbitration in Asia.

Consequences

What does this expanded flexibility in choosing arbitral institutions, seats and firms mean for the users of international arbitration? Predominantly, it means that if used strategically, parties may profit from agreeing on arbitration seated in Asia or under administration of an Asian institution or both.

First, the proposition of an Asian arbitral institution or seat may be used as bargaining tool in contract negotiations. For instance, agreeing on a (specific) Asian institution or seat can be traded for a specific substantive law or commercial benefit.

Further, agreeing on an Asian institution or seat may be of advantage in terms of the acceptance of the dispute resolution procedure itself as well as any resulting award. If the administrating institution or arbitral seat is in Asia, Asian parties may be more willing to abandon litigation in favor of arbitration in the first place or to participate benevolently in arbitral proceedings once a dispute has arisen. Also, Asian arbitral institutions will often have a better understanding of Asian culture, realities and legal systems, giving them an advantage over most European or North American institutions when it comes to administering Asia related cases. Such an awareness in handling cases may again increase the acceptance of arbitration proceedings with Asian parties. Additionally, the higher acceptance of arbitration by Asian parties may even extend to the award itself, not only promoting an effective and fast dispute resolution process, but potentially the voluntary compliance with an award. –>

However, even if an award is not voluntarily complied with and enforcement becomes necessary, an Asian arbitral institution or seat may be of benefit. While in major Asian commercial and legal centers like Hong Kong, Singapore, South Korea or Japan arbitral awards will generally be enforced with the same reliability as in most European or North American countries, this might already be different in some parts of Mainland China. Here, an arbitral award issued under the administration of a Chinese arbitral institution, including such based in Hong Kong, or issued at a Chinese seat, can enhance the perspectives of an award's effective enforcement. The same can be true of other Asian countries.

Finally, it is important to note that in selecting the optimal arbitration arrangement to suit a transaction, parties can generally choose an Asian institution but with a European or North American seat and vice versa. However, this is not the case where the seat of arbitration is in Mainland China, as the Chinese arbitration law still generally prohibits non-mainland Chinese institutions to administer arbitrations seated within its borders.

Conclusion

To sum up, the fact that arbitration is becoming more Asian has expanded the possibilities for choosing arbitral institutions and seats that can both be agreed in view of the specific needs in any given transaction. As such, it offers more flexibility to users of international arbitration, allowing them to profit from additional bargaining options and from the increased regional acceptance of arbitration as such, arbitral proceedings and resulting awards. ←

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Imprint

Publisher:
Professor Dr. Thomas Wegerich

News staff:
Thomas Wegerich (tw),
Karin Gangl (kg)

Publishing company:

FRANKFURT BUSINESS MEDIA GmbH –
Der F.A.Z.-Fachverlag
Managing Directors:
Torsten Bardohn, Dr. André Hülsbömer
Frankenallee 68-72, 60327 Frankfurt Main, Germany
Number in the commercial register: 53454
Local Court Frankfurt Main
Telephone: +49 69 7591 2217
Fax: +49 69 7591 80 2217

German Law Publishers GmbH
Managing Director and Publisher:
Professor Dr. Thomas Wegerich
Stalburgstraße 8, 60318 Frankfurt Main, Germany
Telephone: +49 69 9564 9559
Fax: +49 69 7591 80 2217
E-mail: editorial@businesslaw-magazine.com
www.businesslaw-magazine.com

Annual subscription: free of charge,
frequency of publication: quarterly

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Graphic-design concept:
Rodolfo Fischer Lückert

Layout:
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