Message from Attorneys in Charge

We are very pleased to present this inaugural issue of Pepper’s French Desk newsletter. Formed in 2010, the French Desk is an initiative intended to better assist French and U.S. clients in their activities domestically and overseas. Members of the French Desk are experienced in a wide range of industries, including manufacturing, aerospace/defense, financial services, IT, health care, and media. A number of our members are fluent in French and well-versed in French practices, maintaining active relationships with cross-border business and legal organizations in France and elsewhere.

In this issue, we cover a range of topics including the enforceability of U.S. punitive damages awards in France, the risk of being responsible for multiemployer plan liabilities as part of asset acquisitions, concerns related to granting too much authority to managers of joint ventures and various items of financial interest.

We sincerely hope that you find our coverage of these matters to be both interesting and helpful, and we welcome your feedback to help us publish future issues tailored to your needs.

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In Fountaine Pajot, U.S. Punitive Damages Awards Ruled ‘Enforceable’ in French Courts: The Continued Movement of French Courts Toward Enforcement of Foreign Judgments

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When French companies do business with entities from other European Union countries, they have a general assurance that any money judgment that the parties obtain in one country will be enforced in the courts of the other. This comfort exists as a result of the Brussels and Lugano Conventions, which extend across the European Community and thus provide (with the exception of limited instances) that a judgment rendered in France will be enforced in Italy, for example, and vice versa.

When that same French company does business with a United States entity, however, there are no such assurances. There is no civil court judgment enforcement treaty between the United States and France or, for that matter, between the United States and any other country. The standard explanation for this discrepancy is that other governments are hesitant to subject their citizens, even in cases in which there may be a clear choice of court provisions in business agreements, to the U.S. court system and, in particular, to paying U.S. jury awards.

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Plaintiffs should craft more reasonable punitive damages remedies, and defendants should realize that punitive damage awards may one day be quite punitive indeed.

It is not that enforcement of civil monetary judgments never happens across borders. Such enforcement, however, occurs almost entirely on an ad hoc rather than a formulaic or rules-based basis. It is, to be blunt, a matter almost entirely within the discretion of the enforcing court, which can proceed largely unchecked and unguided by any recognized principles or restrictions, either from a treaty or other source.

U.S. courts have been instructed since the U.S. Supreme Court’s late 19th century decision in *Hilton v. Guyot*, 159 U.S. 13 (1895) (itself a case involving U.S. and French nationals) to enforce judgments rendered abroad. The *Hilton v. Guyot* court was explicit that this instruction is not dependent upon reciprocity and is, simply, what the Court called a matter of international “comity.”

Historically, French courts have been less willing than their American counterparts to adopt this principle of international comity, particularly with regard to enforcing awards of punitive damages. The frequent approach of French courts to U.S. punitive damages awards has been to, at the most, enforce the underlying awards (the “direct damages”) but not to enforce the punitive elements, which have often been viewed as disproportionate or even against public policy.

The consequence of this infrastructure (or, more precisely, the lack thereof) is that sophisticated parties negotiating cross-border deals more often than not include arbitration clauses in their agreements. These provide that any dispute shall be decided not by a French or American court but by an arbitration tribunal. Arbitration awards, in sharp contrast to court judgments, are the subject of a treaty between the United States and other countries. The 150-plus countries party to the New York Convention of 1958 (officially titled the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards) agree that, with limited exceptions, arbitration awards rendered in the cases of nationals whose countries are signatories to the Convention will be enforced. The enforcing court has very little power to review the underlying arbitration award and is expressly barred from re-examining the merits thereof.

While there is more certainty in arbitration enforcement than in litigation enforcement, a recent decision of the French *Cour de Cassation* may be an indication that the two systems are becoming increasingly harmonized. In the case of *X. v. Fountaine Pajot*, the *Cour de Cassation* was not only receptive to enforcing a large U.S. judgment, but was also specifically receptive to enforcing a component of that judgment in an area that has traditionally brought the most antipathy in foreign courts: punitive damages.

Before any further discussion of *Fountaine Pajot* or its background, it is important to note that Americans should not break out the champagne just yet in recognition of a new era in Franco-American judgment enforcement (nor should French businesses with clients or activities in the United States pack their bags and leave the country). Despite its indication that it would be receptive to enforcing an award of punitive damages, the *Cour de Cassation* actually refused to enforce such award in *Fountaine Pajot*. Like numerous courts before it, the *Cour de Cassation* held that the punitive damages awarded by the U.S. court were disproportionate to the underlying court judgment, and therefore refused to enforce them.

What, then, makes this judgment different and worthy of note? *Fountaine Pajot* involved the type of commercial dispute with which many readers of this article will be familiar: a contract case in which the plaintiffs added a tort claim to increase its damages. The *Fountaine Pajot* plaintiffs bought an expensive catamaran from a French manufacturer. The plaintiffs alleged that the ship was defective and sued for breach of warranty, as well as for fraud. The U.S. court awarded the plaintiffs $1,393,650.12 in direct damages (for repairs to the boat) and an even larger amount ($1,460,000) in punitive damages.

In its holding in the *Fountaine Pajot* case, the *Cour de Cassation* stated that “an award of punitive damages is not, per se, contrary to [French] public policy.” While the *Cour de Cassation* justified its refusal to enforce the punitive damages in *Fountaine Pajot* on
the disproportionate amount of such award relative to the direct damages, it noted that it would have been open to enforcing a more reasonable punitive award that was closer to the amount of actual damages. Such wording leaves open the door a crack to future enforcement, and invites further development without being subject to the absolutes of a preordained “yes” or “no” answer. Another equally valid way of viewing the award is that French businesses can no longer rest completely assured that they are immune from punitive damages awards outside of arbitration.

The Fountaine Pajot holding is consistent with the slow, incremental and, one must now say, steady acceptance of French courts regarding enforcement of foreign monetary judgments. French courts traditionally had employed a five-part test in which the plaintiff had to satisfy, inter alia, that the case was not subject instead to French jurisdiction and that the judgment was neither procedurally invalid nor contrary to French public policy. The traditional five-part test required that: (1) the foreign court must have properly had jurisdiction under French law; (2) the foreign court must have complied with its own procedural rules; (3) the foreign court must have applied the appropriate law under French conflict-of-law principles; (4) the decision must not have contravened French concepts of international public policy; and (5) the decision must not have been a result of fraude à la loi (evasion of the law) or fraudulent forum shopping. Munzer v. Munzer [1964] Rev Crit DIP 344; [1964] Clunet / J Dr Int 302 (Civ lère).

In Bachir v. Bachir, [1968] Rev Crit DIP 98; Clunet 102 (Civ lère), the Cour de Cassation dropped the second condition (that the foreign court must have complied with its own procedural rules). Enforcement of foreign judgments in France continued to be hampered, however, by the French courts’ interpretation of Article 15 of the French Civil Code. In a one-two-punch approach, the courts held that (1) a foreign judgment could not be enforced in cases in which a French court had jurisdiction over the French defendant and (2) “French courts had exclusive jurisdiction over French citizens.” Cuniberti, “The Liberalization of the French Law of Foreign Judgments,” 56 Int’l and Comp. L. Q., 931 (2007).

This changed with the seminal decision in Prieur dv. de Montenach, [2006] Rev Crit DIP 871; [2006] Clunet 1365 (Civ lère). In Prieur, the Cour de Cassation held that Article 15 could no longer be interpreted to confer exclusive jurisdiction of an enforcement-blocking nature. As a result, wrote one commentator, “French defendants will now have to win abroad, and thus to play by (all) the local rules.” Cuniberti, supra, at 936.

Fountaine Pajot is the next step in this development. While the holding in Prieur meant that a French citizen must defend a judgment abroad rather than simply rely on the French courts to refuse to enforce it, the ruling in Fountaine Pajot means that a French court is more likely than ever to enforce such a judgment.

This is not to say that U.S. judgments, or any other foreign judgments, will have a substantially easier time of it in France. As noted above, the Cour de Cassation did not, ultimately, uphold the punitive damages award in Fountaine Pajot. For that reason, international arbitration remains the best and safest enforcement choice. But not all parties have the foresight or (perhaps) inclination to include an arbitration clause in their commercial contracts, and thus there will continue to be contracts that provide instead for litigation and not arbitration (or are silent altogether on the matter). For those parties, plaintiffs should take care to craft more reasonable punitive damages remedies, bolstered by the knowledge that they are no longer engaged in a futile exercise, and defendants should realize that punitive damage awards may one day be quite punitive indeed as the law develops further.
EU High Court Says Single European Community Patent Court Would Break Law

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This article is reprinted from Mr. Singer’s blog, IP SPOTLIGHT:

On March 8, 2011, the Court of Justice of the European Union (EU) dealt a blow to prospects for a Europe-wide patent court, stating that the proposed unified patent court would not be compatible with EU law.

After EU Member States requested guidance relating to a proposed agreement to create a unified patent litigation system in Europe, the High Court issued an opinion (available online at http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=EN&Submit=rechercher&numaff=Avis%201/09) stating that such a court would “deprive courts of Member States of their powers in relation to the interpretation and application of European Union law ... and, consequently, would alter the essential character of the powers which the Treaties confer on ... the Member States and which are indispensable to the preservation of the very nature of European Union law.”

In a press release announcing the opinion (available online at http://curia.europa.eu/jcms/upload/docs/application/pdf/2011-03/cp110017en.pdf), the High Court explained that its adverse decision means that no unified patent court can be implemented unless the agreement to do so is amended, or the applicable EU treaties are modified.

The European Commission is still looking for other ways (visit http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/269&format=HTML&aged=0&language=EN&guiLanguage=en) to reform European patent laws. For example, on March 10, 2011, 25 EU Member States agreed to develop plans for a unitary system for registering patents throughout Europe. The new system, if implemented, would do away with the current requirement to validate patents in each individual country in which patent coverage is desired.

Parallel Debt Mechanism Validated

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The Dijon Court of Appeal recently gave support to the use of parallel debt provisions in France, albeit on a limited basis. Parallel debt provisions are frequently used in French secured transactions to allow a collateral agent to hold security interests for the benefit of a fluctuating pool of secured creditors, but until this decision there was no French case law confirming that they would be enforceable. In a recent decision as part of the safeguard (sauvegarde) proceedings of Belvédère SA (Dijon Court of Appeal, 21 September 2010, RG n° 09/02080), the Court of Appeal stated that the parallel debt mechanism used in a New York law-governed collateral-sharing agreement did not contravene French public policy, disadvantage any class of creditors, or create any risk of double payment of the underlying obligations. The case is currently being reviewed by the French Cour de Cassation, and it remains unclear whether a parallel debt provision governed by French law would be enforceable, but secured creditors of French debtors should take a degree of comfort in knowing that existing security packages have avoided a potential challenge.
In light of a recent Third Circuit decision (Einhorn v. M.L. Ruberton Construction Co.), investors considering an asset purchase in the United States have new reason to perform due diligence not only against the targeted assets, but also against the seller. Failure to do so could result in unanticipated liabilities if the seller has unpaid multiemployer benefit plan contributions or potential withdrawal liability.

A benefit plan is generally a “multiemployer plan” if it is maintained by more than one employer in connection with an agreement with one or more labor organizations. Under ERISA and the terms of a multiemployer plan, an employer is liable for its regular contributions to fund its employees’ benefits. Additionally, an employer that withdraws from a multiemployer plan may have “withdrawal liability” imposed based on the employer’s share of the plan’s unfunded vested benefits.

If the assets of an employer that contributes to a multiemployer plan are sold, such sale will often trigger a withdrawal unless the buyer assumes the contribution obligations and other technical requirements are satisfied. If a sale of assets constitutes a withdrawal, or if an asset seller is delinquent on its contributions to a multiemployer plan, the common law rule of successor liability applies unless the parties have specifically allocated the liability before the completion of the transaction.

The general common law rule of successor liability provides that, in a sale of assets, the liabilities of the seller do not automatically transfer to the buyer. However, courts have developed exceptions to the general rule, including:

- the express or implied agreement to assume the selling company’s liabilities
- an asset sale that constitutes a de facto merger
- an asset sale that is for the fraudulent intention of avoiding liability for the seller’s debts
- a sale in which the purchaser corporation is simply a restructured or reorganized form of the seller’s corporate entity, and

- when necessary, as considered in Einhorn, to protect important employment-related policies.

The Third Circuit held that a purchaser of assets, like the purchaser in the Einhorn case, may be liable under ERISA for delinquent pension and welfare plan contributions of the seller in cases in which the buyer had notice of the liability for those contributions before the sale and there exists sufficient evidence of continuity of operations between the buyer and seller. The Third Circuit court further held that the notice inquiry centers on whether the buyer knows about the debts, not whether the buyer knows that the funds intend to seek recovery. The Third Circuit noted the following relevant factors with respect to the continuing operations requirement:

- continuity of the workforce, management, equipment and location
- completion of work begun by the predecessor, and
- constancy of customers.
The *Einhorn* decision, together with several other relevant cases, highlights the increasing scope of successor liability in the context of asset sales. Asset purchasers may be unable to avoid withdrawal liability or liability for a seller’s delinquent contributions to a multiemployer plan, even if the purchase agreement expressly provides that the seller will retain such liability. Asset buyers should therefore perform due diligence and assess risk accordingly in cases in which a seller has multiemployer plan liabilities. To the extent such liabilities exist, buyers could consider that the purchase proceeds be applied in part to satisfy them as a condition to the sale. We encourage any clients considering an asset purchase or other investment in the United States to contact us for further information on issues to be addressed in order to achieve your objectives.

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**Pepper Hamilton Enhances Financial Services Practice with Addition of R. Lee Vanderpool**

R. Lee Vanderpool joined the firm as of counsel in the firm’s Financial Services Practice Group, resident in the Philadelphia office.

Mr. Vanderpool concentrates his practice on banking and financing matters, including a wide range of finance transactions, including acquisition financings, real estate financings, restructurings, commercial paper financings and secured/unsecured syndicated loan transactions.

Before joining Pepper Hamilton, Mr. Vanderpool was a senior associate in the Paris and New York offices of Clifford Chance.

“I am very excited at the opportunity to further develop my practice with Pepper Hamilton and to be part of their commitment to the financial services market,” said Mr. Vanderpool.

Richard P. Eckman, chair of the firm’s Financial Services Practice Group, added, “We are excited to have someone with Lee’s depth and breadth of experience join us. His international experience will be particularly helpful to our clients.”

Mr. Vanderpool received his J.D. from Tulane University Law School (*magna cum laude*, European Legal Studies Certificate), his M.B.A. from the A.B. Freeman School of Business at Tulane in 2001, and his B.A. in international studies from Emory University in 1997.
When first entering the U.S. market, a number of foreign companies choose to form joint ventures with existing U.S. companies. The partners will often choose to organize their joint venture in the form of a limited liability company (LLC), with the U.S. company serving as the manager and the foreign company acting as a passive member. So long as their interests remain aligned, there are a number of benefits to this route for both parties involved. There is a risk, however, that a manager will overstep its bounds and cause the LLC to take an action that was not approved by the passive member, jeopardizing its investment and ability to continue operations.

The Tenth Circuit Bankruptcy Appellate Panel (BAP) was recently asked to consider whether a manager of an LLC had the authority to file for Chapter 11 bankruptcy protection on an LLC’s behalf if the LLC’s operating agreement specifically prohibited the manager from doing so. (DB Capital Holdings, LLC v. Aspen HH Ventures, LLC (In re DB Capital Holdings, LLC), 2010 Bankr. LEXIS 4176 (B.A.P. 10th Cir. Dec. 6, 2010).) The BAP answered in the negative and dismissed the bankruptcy case on the basis that the LLC’s operating agreement expressly barred the manager from filing a bankruptcy petition. For a more complete analysis of the case and its implications, please read “United States Bankruptcy Appellate Panel of the Tenth Circuit Upholds Provision in LLC Agreement Prohibiting Filing of Bankruptcy,” available at http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1976.

Although the above-referenced case specifically dealt with a manager’s ability to commence bankruptcy proceedings, it serves as a useful reminder of the need to draft LLC operating agreements carefully. A manager’s power and authority must be broad enough for it to conduct the LLC’s business in the ordinary course, but also sufficiently limited to protect the interests of its passive members. We encourage any clients considering an investment in the United States or with existing investments in the United States to contact us for further details on how to properly draft LLC operating agreements and protect your interests.

French President Nicolas Sarkozy continues to use France’s presidency of the G8 and G-20 to press his case for a financial transactions tax. The proceeds of the tax would purportedly be applied to environmental and development projects, while providing a disincentive for excessive financial speculation. The United States remains strongly opposed to the proposal, but following a recent meeting of finance ministers and central bank governors from G-20 nations in Paris, French Finance Minister Christine Lagarde indicated that the idea has some support from Germany. Such a tax, if not adopted concurrently across the G-20 countries, could have a disproportionately chilling effect on those countries that elect to impose it. Nevertheless, Mme. Lagarde appeared determined to show France’s resolve in support of the fiscal policy, saying in a recent television interview that, “[N]o matter what, along with other countries that are willing, we plan to put into place financial taxation.”
CLOs Face Consequences of Article 122a Risk Retention Rules

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The Committee of European Banking Supervisors released its final guidelines on Article 122a of the European Union (EU) Capital Requirements Directive on December 31, 2010. Article 122a restricts the ability of EU-regulated credit institutions to take credit exposure to securitizations that do not respect the mandated risk retention requirements, which essentially require that the originator, sponsor, or original lender retain 5 percent of the economic risk of the securitization. Article 122a takes a largely “one-size-fits-all” approach to imposing risk retention requirements across various types of securitizations, including CLOs. Given that CLOs do not fit squarely with other securitizations, however, there are various concerns about how they will be able to satisfy the newly mandated requirements. Fortunately, CLOs existing before January 1, 2011 are “grandfathered in,” meaning that the risk retention rules will not apply to them so long as they do not purchase or substitute assets after December 31, 2014. The new restrictions will potentially have a chilling effect on new CLO creation, however, given that until a satisfactory method of meeting the risk retention requirements is generally accepted, such new CLOs cannot be marketed to EU credit institutions or their consolidated group entities. New CLOs should keep these restrictions in mind and consider whether to include limited marketability in the EU among the risk factors listed in their offering materials.