



Class Actions Bulletin

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Firmwide: Lovells launches international class actions unit

Lovells' offices deliver integrated advice

Lovells has announced the formation of a focused group of the firm's dispute resolution lawyers with experience of advising on class action cases often involving multiple litigants in multiple jurisdictions. The Unit will act as a contact point for clients on class action issues and keep a watching brief on legislative and case developments. It will offer clients the tactical benefit of access to an integrated international network able to provide co-ordinated advice across borders.

Lovells has already undertaken a number of initiatives in this area including a regular class actions client bulletin now in its third year, knowledge sharing on international developments and a roadshow of seminars involving partners from the firm's US and European offices.

In addition to a core team from Lovells' main European offices, the Unit will include partners from the firm's US office with direct and up to date hands-on experience of a market where the concept of class actions is firmly embedded. It will also involve partners with relevant practice experience in areas where group action is most likely, including product liability, shareholder disputes and competition litigation.

Patrick Sherrington, global head of Lovells' dispute resolution practice, said:

"Although group litigation is in its infancy in Europe there is momentum behind movement towards a more US-style system. Lovells' established US presence, European network and vast experience in cases involving multiple litigants across jurisdictions make us uniquely placed to advise clients defending group litigation".

Neil Mirchandani, London dispute resolution partner and co-ordinator of the Unit, added:

"The formation of the Class Actions Unit comes at a time when a number of continental European jurisdictions have implemented or are considering legislation to introduce new group litigation procedures. The Class Actions Unit offers a co-ordinated cross-jurisdiction and practice area team able to provide experienced strategic and technical legal advice wherever and whenever an issue arises".

Other developments include the announcement by the EU Consumer Affairs Commissioner in March 2007 of proposals to introduce into the EU new rules on collective redress by consumers which would enable representative bodies to aggregate claims on a pan-European basis. More recently the Royal Dutch Shell case brought in the Netherlands involved the use of a new collective settlement procedure to settle claims arising out of the company's restatement of its oil reserves.

In addition, recent developments in the UK legal system, while unlikely to lead to full scale US-style class actions in the short term, may result in increased group litigation activity. These include:

- OFT proposals on changes to competition law claims which, if adopted, would allow claims by groups of consumers and businesses. These claims could have some of the features of US class actions. The OFT held a hearing on its proposals, on 24 September 2007;
- developments on the funding side, such as use of third party funding and contingency fees;
- the arrival of US claimant-side specialists in Europe; and
- the Companies Act, in force from October 2007, introduces a statutory right for shareholders to sue directors by way of derivative action and may increase the likelihood of group actions brought by shareholders against company boards.



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UK: Enemy at the gates? Proposed changes to class action funding arrangements in England and Wales

A gathering storm

Should boardrooms be battering down the hatches and preparing for an onslaught of US-style class actions? The Civil Justice Council¹ (“CJC”), an advisory body to the government on issues relating to the modernisation of the civil justice system, has recently published its most recent recommendations that contingency fees be introduced in England and Wales in multiparty cases where no other form of funding is available, along with further liberalisation of third party funding for claimants.² These recommendations are in line with a consensus emerging in England and Wales, including from governmental bodies such as the Office of Fair Trading (“OFT”) and the Department of Trade and Industry (“DTI”), that access to justice can be improved by changing the litigation system to better facilitate multiple-claimant actions.

The strong impression that significant changes are on the way is strengthened by similar developments in several other European countries. For example, German courts have recently ruled that the country’s prohibition of contingency fees is illegal. The European Commission itself is considering measures to improve mechanisms for consumers to pursue group claims in the spheres of consumer protection and competition. Meanwhile, US law firms specialising in class actions have recently set up shop in London and several City firms are following their lead by preparing for an increase in class action work.

While the UK government has not yet announced any concrete plans, it is clear that there is a current level of enthusiasm to make changes to assist individuals in achieving better access to justice. Do UK companies, then, need to prepare themselves for an onslaught of class actions if the recent funding proposals take effect?

Cashing in

Proper funding of claims is arguably the most important factor in creating an effective system in which multiple-claimants can test their legal grievances against those who allegedly commit wrongdoing on a widespread scale. The high costs of pursuing litigation and the risks of the consequences of failure have been identified by the OFT as key obstacles to the bringing of group claims.

There are two key aspects of funding arrangements that it has been suggested be introduced to England and Wales: contingency fees and liberalisation of third party funding.

Contingency fees

Current funding arrangements available to group claimants often combine conditional fee arrangements (“CFAs”) with after-the-event (“ATE”) insurance in an attempt to circumvent the difficulties that groups of individuals can face in financing their claim. Broadly, under a CFA (popularly known as ‘no win, no fee’), a client pays, in addition to his or her normal legal fees, an additional success fee, calculated as a percentage of the normal fees owed (capped at 100% of those fees), but only if the claim is successful. If a claim is unsuccessful no or reduced legal fees are owed. ATE insurance provides cover in the event of losing a claim, and most importantly covers the other side’s legal fees. However, dependency upon these mechanisms alone has been criticised as failing to provide sufficiently wide access to justice for individuals wishing to bring group claims, as evidenced by the fact that they have not been widely used in the commercial context.

Perceived weaknesses in the ATE insurance market and the fact that, even with CFAs in place, claimants are still liable to pay the other side’s costs if a claim is unsuccessful, have encouraged the CJC to recommend that (carefully regulated) contingency fees be introduced for use in multiparty cases where no other form of funding is available. Contingency fees would allow lawyers to claim a fixed share of the damages won by a successful claimant, and would provide lawyers with a greater incentive to accept instructions to act for large groups of claimants as remuneration under contingency fees is potentially much higher than that under CFAs (which are capped at double the usual fees).

Third party funding

The CJC also recommends that third party funding, within a framework of rules ensuring careful regulation of such funding arrangements, be given a greater degree

1 The advisory public body with responsibility for overseeing and co-ordinating the modernisation of the civil justice system in England and Wales.

2 ‘Improved Access to Justice – Funding Options & Proportionate Costs’, June 2007, Civil Justice Council.

of acceptance. Commercial enterprises are already involved in the funding of some group claims in England. Hedge funds and private investors are increasingly looking on class actions as an investment opportunity. What was once a rarity is now gaining government and judicial sanction as third party funding is increasingly regarded as a key element in efforts to improve access to justice. The Court of Appeal's 2005 decision in *Arkin v Borchard Lines*³ held that the courts will cap the costs liability of a third party funder to that which the funder agreed to provide at the outset and no more (though note that the courts retain discretion to impose unlimited liability for costs against funders in situations where the court holds that a funding agreement has given the funder an unjustifiable degree of control over the proceedings). Thus, commercial funders who provide help to those seeking access to justice, which they could not otherwise afford, should not be deterred by the fear of disproportionate costs consequences if the litigation they are supporting does not succeed. Whilst third party funders would be likely to cap the funds provided in order to limit their exposure, the *Arkin* decision is generally regarded as encouraging to those looking to invest in class action litigation in England and Wales.

But not too fast...

The changes to funding arrangements appear likely to be introduced, particularly given the encouragement that they have received from a number of bodies to date. However, it should be noted that England and Wales still lack several of the factors responsible for the US class action-fuelled compensation culture.

Unlike in the US, civil actions in England and Wales are only very rarely heard in front of a jury and thus the huge damages often awarded by US juries are not a motivating factor for UK-based claimants to issue large claims and bear the associated risk. Furthermore, the 'loser pays the winner's costs' rule, which shows no sign of being abandoned, will continue to serve as a deterrent to claimants and third party funders alike to bring unmeritorious claims. England and Wales also lack the concept of a 'class' of claimants which typifies US litigation. In the US, proceedings can be brought on behalf of a class of unnamed individuals who need not actively 'opt in' (that is, take positive steps to join) to the proceedings. In England and Wales, claimants must still actively 'opt in' to proceedings, which has traditionally resulted in lower participation rates. Finally, the various government and independent bodies driving these changes forward, such as the OFT, the DTI and the CJC, do appear to be conscious of the criticisms of the US system and keen to avoid the excesses, which are perceived to permeate US group litigation.

Conclusion

New funding arrangements for class actions are certainly on the horizon and, if implemented, are likely to play a key part in facilitating a raft of new group actions. However, to what extent they will have a bearing on the evolution of group litigation in this jurisdiction will depend on exactly how far the proposed developments to the system eventually go, and how cautiously (or otherwise) the government walks the line between achieving greater access to justice and importing a US-style compensation culture.



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Recommendations of the Civil Justice Council in its report dated June 2007

- A Contingency Legal Aid Fund ("CLAF") should not be established under the current cost regime of England and Wales.
- A Supplementary Legal Aid Scheme ("SLAS") should be established and operated by the Legal Services Commission.
- Properly regulated Third Party Funding should be recognised as an acceptable option for mainstream litigation. Rules of Court should also be developed to ensure effective controls over the conduct of litigation where third parties provide the funding.
- In multi party cases where no other form of funding is available, regulated contingency fees should be permitted to provide access to justice. The Ministry of Justice should conduct thorough research to ascertain whether contingency fees can improve access to justice in the resolution of civil disputes generally.

3 [2005] 3 All ER 613.

Germany: KapMuG: Two years on

As reported in previous editions of the Bulletin, “The Law for the introduction of capital investor representative proceedings” (KapMuG) came into force in Germany on 1 November 2005. The legislation aims to protect German investors by enabling group actions to be brought in the context of securities litigation in circumstances where there is incorrect, misleading or omitted capital market information relating to shares and other investments included, for example, in prospectuses and annual financial statements and at shareholders’ meetings.

Two years on, and with the procedure having now been used on a number of occasions, we consider whether the KapMuG has passed its first practical tests.

The KapMuG procedure: A recap

Procedurally, the KapMuG allows a number of first instance proceedings to be handled together by means of a lead case procedure. The mechanism involves four stages:

Stage 1

Separate proceedings are brought by each claimant who wishes to file a claim before a court of first instance.

Stage 2

To commence the lead case procedure, prospective claimants must make an application to the court of first instance. If the court regards the application as admissible, it makes an order to transfer the action to the Higher Regional Court (“OLG”) with jurisdiction for this action. The parties to at least nine further cases relating to the same matter must also request lead case treatment within four months of the announcement that the first application has been made in order to trigger the establishment of the KapMuG mechanism.

Stage 3

At the discretion of the OLG a lead case is then selected and considered, following which the first instance proceedings are stayed. The OLG decides upon the particular issues of fact and/or law common to the claims and an order is issued (referred to as a sample/model notice). This order also binds the parties in the cases before the lower courts, regardless of whether those particular claimants have actively participated in the lead case.

Stage 4

The stay in the first instance proceedings is lifted and the order applied. This is the case even where those proceedings do not raise precisely the same issues. It is sufficient that the particular fact and/or law identified by the OLG as being common to the lawsuits is the same.

The application for lead case procedures is only granted if the claim is (i) for damages arising out of allegedly incorrect information that is publicly available or (ii) for performance of a contract based on a bid under the Acquisition of Securities and Companies Act (Wertpapiererwerbs- und Übernahmegesetz). The information in question must be crucial for the decision on, or resolution of, the individual case.

A success?

The two prominent lead case procedures that have been lodged under the KapMuG have revealed some procedural weaknesses.

Weaknesses and problems identified

The most high profile KapMuG proceeding is that of the claims filed by approximately 17,000 individuals against one of the world’s leading telecommunications companies for having allegedly overstated in its listing prospectus the value of its real estate. In addition to the main lead case, there are several other applications for a model suit in other cases against this company alleging different failures to report information to the market or reporting incorrect inside information.

The lead case has now been pending before the Higher Court of Frankfurt for over 14 months. However, the lead case hearing cannot take place until the courts of first instance in which each of the 17,000 claims were filed have decided whether to stay each of those individual claims. The defendant has raised objections to the stays, arguing, for example, that the claims have become time-barred, and that the claimants have not sufficiently proven their ownership in the company’s shares at the relevant time. Each decision must be reached on a case-by-case basis, causing significant delay. Since the parties will only be joined to the lead case if the first instance proceedings are stayed, and given that the sample order only binds

those parties that are so joined, the order to stay the first instance proceedings is of crucial importance.

It would have been very time-consuming and expensive for each case to have been heard and adjudicated upon separately. The KapMuG was designed to enable multiple cases which rest on complex yet common facts to be dealt with more efficiently and to prevent them becoming time-consuming lawsuits. However, the benefits of the KapMuG for investors are minimal if the lead case procedures also take a long time.

The same delays arose in the second prominent KapMuG proceeding that was brought against a German/US car manufacturer. 60 shareholders brought an action for the allegedly belated ad hoc announcement of the resignation of its former CEO. It took a year until the lead case procedure was opened and a hearing could be scheduled as a result of the delay in obtaining stays of the first instance proceedings. On 15 February 2007, the Higher Regional Court of Stuttgart¹ dismissed the lead case, ruling that the company's announcement about the CEO's resignation in July 2005 was made in due time. According to the judges, the car manufacturer was not obliged to inform the public before the unanimous supervisory board decision on the CEO's premature departure. An appeal has already been brought against this decision before the German Federal Court of Justice. A final decision on the model case is not expected before next year and therefore the decisions of the courts of first instance on the pending cases are once again being delayed.

Conclusion

The introduction of class action style procedures in certain fields in Germany is the right step towards managing a large number of claims arising from events that have affected a large number of individuals. However, it is clear that the KapMuG mechanism must be improved in order to turn it into an effective and time-saving procedural tool for use in securities litigation. The KapMuG will remain in force until 1 November 2010 unless the legislator decides to extend this period. Given that claimant lawyers are increasingly relying upon group actions and that courts recognise an obvious need for a procedural tool to handle group actions, it is expected that the legislator will arrange for necessary amendments to be made to remedy the procedural weaknesses of the KapMuG. Given (i) the recent statements of Meglena Kuneva, EU consumer affairs commissioner, on the introduction of a new system of "collective redress", which will allow European consumers to bring claims against providers of faulty goods or services and (ii) the recent judgment of the German Federal Court of Justice that allowed group

actions in consumer matters for the first time (see the Spring 2007 edition of the Bulletin), the legislator might even extend lead case procedures to other fields of law typically involving a large number of cases based on the same grounds of fact and law, such as product, pharmaceutical or environmental liability.



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¹ Reference number: 901 Kap 1/06.

France: Update on the introduction of class actions

Since former President Jacques Chirac's announcement in 2005 that a working group would be charged with the design and implementation of a class action procedure *à la française*, several important events have taken place, notably much debate, three different bills and a newly elected President, Nicolas Sarkozy.

President Sarkozy's announcement in July 2007 that there would be a bill introducing class actions in France by the end of 2007 provoked a new debate among consumers' and employers' organisations. MEDEF, the French confederation of employers, sees the class action *à la française* as an assault against businesses. At the other end of the spectrum is UFC-Que Choisir, the leading consumer group, which sees the class action mechanism as a tool to help protect consumers. A petition (www.ensemblenjustice.org) filed by consumer organisations, including UFC-Que Choisir, has registered more than 100,000 signatures to date in favour of class actions. This petition promotes the "opt-out" class action system (as used in the US), in which members of the class must explicitly ask to be excluded from the class action litigation.

Beyond this debate, a vast majority of French people would apparently be happy to be able to benefit from class actions, according to a survey conducted in spring 2007. The looming question is whether the class action system proposed in the new bill will more closely resemble the former governmental bill drafted in November 2006 or the National Assembly bill drafted in April 2006 by the current Secretary of Consumer Affairs and Tourism, Luc Chatel. The former governmental bill featured an "opt-in" class action system, meaning that claimants must choose to join the action in order to be considered a member of the class. The National Assembly bill drafted in April 2006 gave a choice between the "opt-out" and "opt-in" class action systems, depending on the amount of damages at stake in the individual case.

Despite the fact that in July 2007 President Sarkozy requested that the French Minister of Economy draft a class action bill, he appears to be more sceptical about class actions than his predecessor, President Chirac. It is notable that President Sarkozy has not mentioned the introduction of class actions in either of the two speeches on his economic policy made since September 2007. Whilst it appears that President Sarkozy does

intend to create a class action procedure, the features of such a bill, which is expected to be submitted to the National Assembly in spring 2008, are yet to be defined.



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US: New standard for pleading scienter in private securities fraud cases may lead to continued drop in class action filings

In June, the US Supreme Court announced a tough new standard for pleading scienter (that is, a defendant's intent to deceive, manipulate or defraud) in securities fraud actions, making it more difficult for private plaintiffs to successfully bring such actions going forward.

Plaintiffs in *Tellabs, Inc. v. Makor Issues & Rights, Ltd* alleged that Tellabs violated Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder. The district court twice dismissed the complaint because the plaintiffs' pleading failed to create the "strong inference" of scienter necessary to state a valid claim. The Court of Appeals reversed the decision, concluding that the complaint should survive because a reasonable person could infer from the complaint's allegations that the defendants acted with the requisite scienter.

The Supreme Court reversed the Court of Appeals' decision, agreeing with the district court that the complaint failed to adequately plead scienter. Aiming to prescribe a "workable construction" of the statutorily prescribed "strong inference" standard, the Supreme Court rejected the Court of Appeals' "reasonable inference" test. The Supreme Court held that plaintiffs were entitled only to the most plausible of competing inferences, and that courts determining whether an inference of scienter is "strong" must consider not only inferences favouring the plaintiff, but also a defendant's plausible non-culpable explanations for its conduct. To be "strong" an inference of scienter must be more than merely plausible or reasonable; it must be "cogent and at least as compelling as any opposing inference one could draw from the facts alleged".

Tellabs ends considerable debate about what suffices to create a strong inference of scienter under the federal securities laws. The decision has the practical effects of making it more difficult for plaintiffs to allege securities fraud and making it easier for defendants to end a lawsuit at the motion to dismiss stage.

If new securities class action filings are reduced because of *Tellabs*, they will fall to record or near-record lows. In the first half of 2007 – before *Tellabs* – 42% fewer securities class actions were filed relative to the average number of semi annual filings made during the nine year

period ending June 2005, according to a study published by Cornerstone Research.



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