



## GLOBAL LEAGUE: BUSINESS GROUP REPORT

Chicago 2016

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## **INVESTMENT AND DEVELOPMENT: GLOBAL SUPPLY CHAINS AND BUSINESS NETWORKSK.**

Rapporteur: Wanderley Fernandes

### **1. REPORT OF ACTIVITIES**

Before reporting the matters under research by our group, it is important to make reference to some joint activities developed by our members since the last Academic Meeting. One of the purposes of this group is fostering a real academic network, stimulating joint research and activities.

Our first research was connected with a very specific topic on enforcement of international arbitration. The decision taken in Torino in 2014, in our first preparatory meeting, was guided by the idea that, as a first joint activity, we had to be very effective and with a clear task. Then, the case law research was carried out by members of our group in their own jurisdiction, with a summary report made by Zeynep Tarman, Francisco Elizalde, and Wanderley Fernandes. Despite the joint report, the research was conducted separately by each subgroup.

After that first work, in our preparatory meeting held in Madrid, in 2015, we decided to take a step forward and develop a more comprehensive work in order to incentive a real exchange of ideas and joint research. We prepared a project to investigate the structure and governance of global value chains in different markets. Such project was, then, presented in Cape Town.

In this project, we can observe that our purpose of integrating our members is being achieved. Every subgroup now is integrated by members from different countries working together.



Moreover, our participants have been working together in different arenas as result of our network. In this sense, we can note that, in the last three years, we had business courses in co-teaching among our members offered in the LSGL summer courses. The connections established among the schools have also promoted exchange of professors and participation in seminars and relevant events. Recently, for instance, Francisco Elizalde Ibarbia, from Instituto de Empresas, have coordinated a congress about EU uniform contract law and several members of our group were invited to take part of this important event.

Future activities, as webinars, publication of papers, joint courses in different schools are in process of being implemented. In Chicago, the group will have a separated meeting to discuss the organization of an open seminary in our next preparatory meeting in order to fully discuss the topics of our research among our members and the academic community.

We are also glad to inform that we have several new members, from China, Canada, Turkey, Brazil, Belgium, including students of our schools, and we hope to improve and expand our academic network, as a sort of international “think tank” on business law.

## **2. PROJECT INVESTMENT AND DEVELOPMENT**

In Cape Town, we proposed the following topics for our joint research:

### **General framework: Investment and development**

- Global value chain concept;
- Governance of the global chain: applicable law, seat of arbitration, liability, Interaction with public policy; interaction with international organizations;
- Risk assessment and mitigation, can financing or insurance players determine/impose the governance of the chain?



- Corporate social liability: the tension between private and public determination about what are the social priorities;
- Social human aspects of direct investments (tradeoffs). The denunciation of BITs as a way to preserve regulatory space: the case of South Africa.
- Investment “determinance”: private and public point of view:
  - tax incentives;
  - legal rules (choice of applicable law)
  - economic development and law.

As the work progressed, in our preparatory meeting, in Torino, 2016, the group decided to focus our attention on the oil and gas market in connection with the following topics:

- Competition issues (Gazprom case);
- International arbitration difficulties dealing with corruption;
- Corporate governance: corporate decision mechanisms; creative accounting and fraud; incentive mechanisms;
- Impact of corruption in business network (Petrobras case)
- Managers liability; corporate liability; and contractual liability.

Despite the existence of a specific group dealing with anti-corruption studies, we also decided to analyze the impact of corruption on the oil and gas value chain. As we have four members that are also participants of the anti-corruption group, that cooperation may allow us a fruitful exchange of ideas between these two groups.

Now, as reported by each subgroup, we have some papers and work still in progress. All the material received is attached to this report as working papers, outlines, syllabus, and material in preparation for seminars.

Instead of paraphrasing each material, I will reproduce relevant excerpts of each work.



### 3. GLOBAL VALUE CHAINS: AN INTRODUCTION

Professors Maria Lucia L.M. Padua Lima and Paulo Goldschmidt (GV Direito SP) have written the introduction about the concept of global value chain, as a sort of economic guideline to explore the legal consequences, issues, problems, and challenges arising out such form of economic network.

In their words:

“The theoretical basis for this approach is found in the literature<sup>1</sup> dealing with the emergence of a global production system. Thus, we intend to address the changes in the role of transnational companies by analyzing the characteristics and the nature of these changes from the concept of global value chains (GVC)<sup>2</sup>. The central hypothesis is that these changes have important consequences in the contractual relations between the various parties that make up the numerous GVC.

According to the GVC approach, economic integration transcends the world trade in raw materials and finished products and comprises an internationally dispersed production process with a central coordination that goes beyond the vertical corporate and national boundaries.

It can be considered that the GVC takes two predominant forms: productive chains controlled by supply (producer-driven) and demand (buyer-driven). In the first case,

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<sup>1</sup> In the collection of articles edited by Gereffi and Korzeniewicz (1994) a methodology for analyzing the global production system is developed. The main argument of the authors is that despite the internationalization process - understood as the geographical dispersion of economic activity - has started in the seventeenth century, globalization is a contemporary phenomenon that involves the coordination and integration of internationally dispersed economic activities. From this emerges the coordination and integration of global production system. Other important works within this line of argument are: Amin and Theriff, 1994; Conti, 1995; Gereffi, 1994; Gereffi and Korzeniewicz (ed.), 1994; Gereffi, 1999 Stallings, 1995; Massey, 1997; Kaplinsky, 1998.

<sup>2</sup> The global supply chain concept considers four dimensions: 1) integration of inputs-product flows between industries; 2) territorial coverage; 3) governance structure; 4) Local institutional framework, national and international



the manufacturing industry has control of the process (governance) organizing the entire production network (forward and backward linkages). Generally, GVC led by the offer is related to typical activities based on intensive capital and technology. Classic example of this form of organization is the automotive industry that has the automaker controlling the entire network of suppliers, distributors and retailers. Other examples of GVC controlled by supply (producer-driven)<sup>3</sup> are the aeronautical, computers, semiconductors and heavy equipment.

On the other hand, in the GVC led by demand (buyer-driven) the organization's format is given by the closest link to the consumer, in other words, the characteristics of the consumer markets are the determinant factor to the production. For this reason, the major retailers, traders and producers with brands are the controllers of this type of GVC. These GVC usually are related to labor-intensive products and include various consumer non-durable goods - textiles and clothing among them. In this case, the production is often decentralized with plants located in various regions of the world, especially in emerging countries. On the other side, the main markets of these goods are often located in advanced countries. For this reason, these GVC are usually under control of the final players in the process.”

#### **4. THE FUTURE OF INVESTMENT LAW IN A POLARIZED WORLD: Brazil, Canada, and the United States as exemplars of the North-South debate over the legitimacy of the investment law regime**

One of the ideas that we have been discussing since the last academic meeting, in Cape Town, is the proposition of co-teaching courses for the LSGL summer courses connected with our subject of research. This year, professors Andrea K. Bjorklund (McGill University) and Daniel de Andrade Levy (GV Direito SP) prepared a co-teaching course about the investment law regime. As defined in Cape Town, our broader topic would be

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<sup>3</sup> Gereffi, 1994 and 1999



“Investment and development” and, therefore, the course was developed in line with our main topic. The course will be the basis for a joint paper.

They describe the course as follows

“Although Brazil is the sixth most attractive economy for foreign investment according to the UNCTAD, it has never approved any Bilateral Investment Treaty to promote protection for these investments. At the same time, countries like Venezuela and Ecuador have partially withdrawn from the Investment System, having denounced the Washington Convention, and South Africa and Indonesia are in the process of terminating their investment treaties. However, if the Southern perspective seems quite pessimistic on the future of Investment Protection, countries like Canada and the United States have continued to negotiate and even to conclude important new agreements, including the mega-regional Trans-Pacific Partnership (“TPP”).

Therefore, taking this scenario of opposites into consideration, the course will be a rare and unique opportunity. It will gather professors from different backgrounds in order to discuss how their respective regions have been protecting their foreign investors. The debate will lead to an interesting comparative approach of the different concepts of investment protection laws in the North America conventions, such as the NAFTA and the recently approved TPP, and in the internal law of the Latin America countries which have not joined any of these instruments. We will also explore some of the recent European Union proposals for an investment “court”.

The final question to be answered will be: is the treatment of foreign investors provided by the international investment system represented by the North countries equal to the protection given by the internal law of the South countries? If so, do we still need foreign investment protection law?”

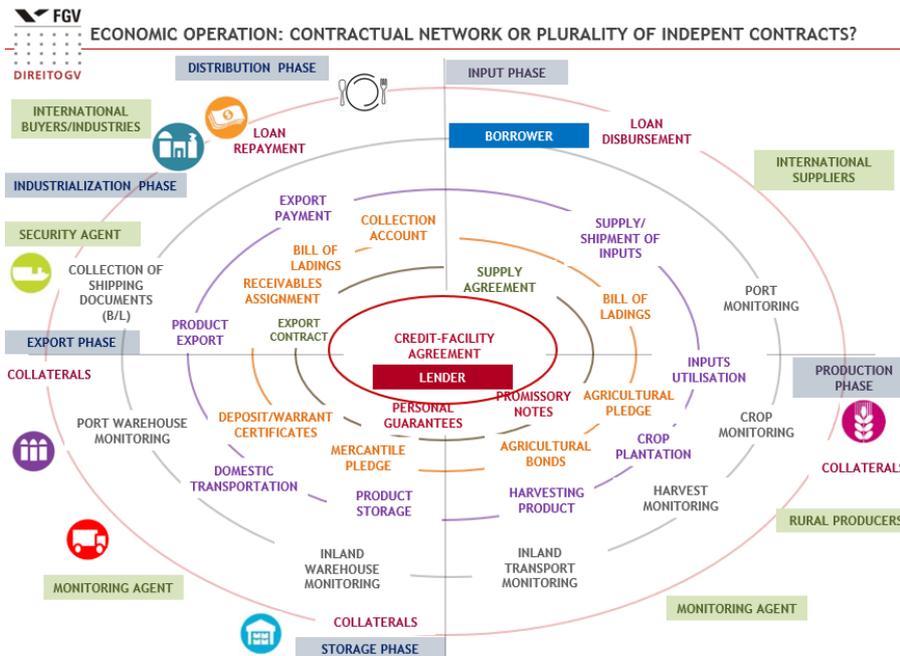


## 5. NETWORKS: NON-CONTRACTUAL LIABILITY AND CONTRACTUAL ISSUES

This topic has been discussed and developed by professors Prof. Francisco Elisalde Ibarbia (Instituto de Empresas), Isik Onay (KOÇ University), Paulo Doron de Araujo (GV Direito SP), and Wanderley Fernandes (GV Direito SP).

“Network is not a legal concept”(Gunther Teubner)<sup>4</sup>, but certainly has several legal implications without a clear answer from any system of law. The idea of network as connected contracts may not be sufficient to explain modern form of economic organization. The line separating contracts and firms is overcome by dynamic transnational networks.

The chart below, prepared by Heloisa Slav (former student of the professional master program of GV Direito SP) illustrates how the global chain in the agribusiness market can be an intricate network of transactions and contracts.



<sup>4</sup> Network as connected contracts. Oxford: Hart Publishing, 2011.



Professor Isik is preparing the material regarding non-contractual liability (tortious) within the network, specifically applied in the oil and gas Market in Turkey.

“It is not clear whether this article regulates strict liability or not. However in any case, oil and gas companies will be subject to strict liability due to Art. 71 of the Turkish Code of Obligations (TCO) which entered into force in July 2012. TCO Art. 71 imposes strict liability on proprietors of enterprises engaging in dangerous activities. For the article to apply, the enterprise causing the damage shall be engaged in an activity which involves a certain degree of danger. The article only applies if the activity is, due to its nature or the materials or equipment used, prone to cause severe damages frequently even if the enterprise is operated with the standard of care to be expected from an expert (TCO Art. 71/2).

Although there have been no reported cases to the author’s knowledge, where an oil or gas company was held liable due to Art. 71 of TCO,<sup>5</sup> consensus exists in the literature regarding their status as enterprises engaging in dangerous activities within the framework of the mentioned article.

Furthermore an oil or gas company may be subject to tortious liability if its activities cause harm to the environment. Art. 28 of the Law on Environment (Law no. 2872, Official Gazette: 11.08.1983, 18132) states that anyone causing damage to the environment is liable irrespective of fault.

Lastly, liability based on trust (*güven sorumluluğu / Vertrauenshaftung*) may be relevant for oil and gas companies. A person may be held liable even in the absence of a contract, if he/she creates an appearance of trust on other persons. If the trusting persons suffer damages due to the betrayal of such trust. The liability based on trust is not specifically regulated under the TCO but is derived from the general duty of good faith under

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<sup>5</sup> The only reported case where liability according to Art. 71 TCO was imposed concerns an electricity distribution company. The company was held liable for damages caused by a fire, which started after a transmission tower fell over.



Turkish Civil Code Art. 2. A textbook example for liability based on trust could be the liability of oil companies, which allow the use of their trademarks in petrol stations. Although the contract for purchasing gas is concluded with the person operating the gas station, the customer buys from this store due to its trust on the oil company. If the customer suffers any damage, which is not related to the product,<sup>6</sup> the oil company may theoretically be held liable.”

Professors Paulo Doron Araujo, Francisco Elizalde Ibarbia, and Wanderley Fernandes, are in charge to investigate the contractual aspects of global chains. How contracts may affect third parties in the vertical and horizontal dimensions of the network, from the owner of the technology, passing through the manufacturer, distributor, vendors, and consumers.

Professor Francisco Izalde Ibarbia will be in São Paulo in November, and together with Wanderley Fernandes and Paulo Doron de Araujo, shall organize a webnair on this topics. Just as an illustration of the matters, I reproduce some slides of the main topics.

## *“Network is not a legal concept”, but it gives rise to many legal issues*

### **Inside regulation**

*“It is inaccurate, however, to characterize networks solely in terms of collaboration and concord. Each point of contact in a network can be a source of conflict as well as harmony. (...) Networks also commonly involve aspects of dependency and particularism.”*

(W. POWEL)

### **Outside regulation**

*“Is the network simply a trust-based relationship between individual actors, or does it form an independent collective, making its appearance as a new actor witch in itself becomes a point of attribution of action and responsibility?”*

(G. TEUBNER)

<sup>6</sup> If the damage is related to the product, the oil company can be held liable due to product liability.



## Inside look: four contract issues

### Penalty Clauses

How do they apply to Networks? Are their legal frame sufficient to solve the new problems?

### Liabilities Limitation

A useful tool on risk distribution or just an easy way to escape contractual duties?

### Liquidated Damages

Do they play a good or a bad role on regulating network business relationships?

### Profits and information sharing

Are these mechanisms authentic Network benefits or are they entrance barriers to a specific market?



## Outside look: four liability problems

### **Anti-corruption Law**

- Collective responsibility?
- Distribution of reputational, administrative and patrimonial sanctions

### **Consumer Rights**

- Is the actual legal frame creating the right incentives?
- Can participants limit their exposure?



### **Environmental Law**

- Risk-profit theories
- Is it possible to mitigate the risks?

### **Civil Liability**

- Responsibility attribution techniques are able to deal with the new phenomenon?



## 6. INVESTOR-STATE ARBITRATION AND CORRUPTION

This topic has been researched by professors Anna Viterbo, Lorenza Mola (both from Univesità di Torino”) and Zeynep Tarman (KOÇ University). They explore the most important difficulties of arbitral tribunals when corruption is a business issue to be decided in the context of investment. The work under development is fully illustrated by case law materials. I reproduce below the item 2 of their report.

### “2 Impact of corruption

#### ***2.1 The arbitral tribunal lacks jurisdiction***

The arbitral tribunal's lack of jurisdiction in case of corruption may arise from three different grounds.

First, Art. 25 of the ICSID Convention implicitly requires the investment to be made validly made according to the host State's requirements, the general conditions of validity of contracts as well as the principle of good faith (*Phoenix Action Ltd v Czech Republic*, ICSID Case No ARB/06/5, Award, 15 April 2009, para. 114; *Saba Fakes v. Turkey*, ICSID Case No. ARB/07/20, Award, 14 July 2010, para. 108); it follows that an investment established through corruption falls outside the “objective definition” of investment.

Second, investment treaties usually afford protection only to investments made in accordance with the host State’s laws and regulations. Hence, if the relevant BIT so requires, an “illegal” investment procured by corruption may be declared to fall outside the tribunal’s jurisdiction (*Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, 4 October 2013, para. 127; see also the respondent government's pleas in *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, 2 August 2006, and paras 157-161).



## ***2.2 Dismissal of a case or denial of a remedy at the merits stage***

Some arbitral tribunals addressed the issue of corruption at the merits stage. This was justified *i)* on the assumption that investment protection only concerns valid investments and *ii)* factual analyses of such hypotheses as corruption requires the kind of in-depth inquiry usually made at the merits stage (*Malicorp Limited v Arab Republic of Egypt*, ICSID Case No ARB/08/18, Award, 7 February 2011, paras 117, 119).

The principle *nemo auditur* also plays as a defense to a claim to unjust enrichment allowing the tribunal to deny a remedy such as restitution in cases of contracts tainted by fraud or corruption.

Corruption of local judges in favor of the government was claimed to amount to denial of justice and to be contrary to the fair and equitable treatment obligation. In this case, the issue of attribution of conduct of a State organ (acting in his private capacity) to the State was raised (*Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador*, UNCITRAL, PCA Case No. 2009-23, Track 2 Supplemental Memorial on the Merits, May 2014, and Track 2 Supplemental Counter-Memorial on the Merits, November 2014).

## ***2.3 Viability of the corruption defense when the State failed to prosecute***

In some cases, the fact that the host State failed to prosecute the individuals allegedly responsible of corruption was taken into account. However, in *World Duty Free Company Limited v. The Republic of Kenya*, (ICSID Case No. ARB/00/7, Award, 4 October 2006, paras. 180-181) and *Metal-Tech* (paras. 308, 336), the tribunals held that corruption was proven and thus dismissed the claims on that basis, even though neither respondent State prosecuted the accused government officials or the individuals who allegedly made the corrupt payments.”



## **7. THE GAZPROM CASE IN THE CONTEXT OF THE SINGLE EUROPEAN GAS MARKET**

Professors Zeynep Ayata and Cem Veziroglu (KOÇ University) have prepared a paper on the antitrust impact of GAZPROM CASE in the context of the European market.

In their own wording:

“From a Competition Law perspective, we first need to underline that Energy Markets constitute regulated markets. The level and aim of regulation will vary according to the relevant product (gas, oil, electricity, etc.) and the geographical market. Energy markets, throughout the world, present certain common characteristics that determine the market structure and its level of competitiveness. Almost all markets will have high barriers to entry marked by state licences and high investment costs. On the other hand, it is not uncommon for regulatory bodies to determine prices in energy markets, which may further restrict competition and increase risks of collusion.

Moreover, energy markets are marked by either an oligopolistic market structure or quasi- monopolies. This common thread in market structure can be explained by two factors: the relevant product and its characteristics or ‘history of the relevant market’ i.e. liberalisation. There are certain products such as fuel oil or bottled gas that generally have non-commercial use and are entirely homogenous. In these markets we also see very few suppliers due to high barriers to entry (usually in the form of legal licenses). Moreover, in most countries prices for these products will be regulated by the State. These markets present therefore a typical oligopolistic structure with high levels of concentration. The second tendency that we see in energy markets is quasi-monopolies, usually the result of liberalization of the market. Most privatizations end with the acquisition of the ex-public monopoly by only one private party. This pattern, combined with high entry barriers in these markets results in quasi-monopolistic markets where there is little or at times no competition that constrains the now privately owned dominant position firms.”



“The Gazprom investigation is to be seen as part of a much larger program initiated in the late 1990s to create a single market in gas. The program mainly includes three energy packages<sup>16</sup> and a sectoral inquiry<sup>17</sup> that brought widespread anti-competitive activities to light. Following the sectoral inquiry in 2005, the Commission’s enforcement activity of antitrust rules in energy sector is very dynamic. The Gazprom case is therefore an issue of completing a wider investigation with the purpose of creating a liberalized European gas market.<sup>18</sup> Hence the Gazprom case is not seen as politically motivated from the EU’s perspective although it is the opposite from the Kremlin’s.”

## **8. OIL AND GAZ SUPPLY CHAIN: SETE BRASIL CASE STUDY**

It is notorious that Brazil has facing one of the most critical economic, political, and ethical crisis. Sete Brasil was formed in the context of euphoric optimism with the perspective of growth brought by discovery of enormous reserves of petroleum in pre-salt layer in deep ocean. The collapse of Petrobras, after a scandalous revelation of billionaire corruption scheme, has spread out its effect in the whole supply chain, and beyond the limits of the oil and gas market. Professors Maria Lúcia Padua Lima, Lie Uema do Carmo, and Paulo Goldschmidt, all from GV Direito SP, are concluding their paper that we expect to be published soon.

They introduce their paper in the following manner:

“This paper examines the case of Sete Brasil Participações S.A. (“Sete Brasil”), a Brazilian company founded in 2010 whose purpose was the management of asset portfolio aimed at oil and gas drilling operations in the Brazilian offshore area, especially those related to the pre-salt oil extraction. This company - currently in pre-bankruptcy proceedings - was one of the targets of major corruption investigations



within the so-called “Operation Car Wash”, due to its close links to Petrobrás – Petróleo Brasileiro S.A. (Petrobrás).

The severe crisis that impacted Petrobrás has created a domino effect within the whole oil and gas extraction and production chain. Sete Brasil was one of the major affected companies.

This paper reviews the oil and gas context in Brazil and the political, economic and legal determinants that led to the creation and development of Sete Brasil and, further, to its crisis and the contagion effect within the chain.

Oil and gas have been the epicenter of the energy matrix from the early twentieth century as a result of the dominance of the automobile industry in the capitalist development. Despite efforts to diversify this matrix based on non-renewable and polluting resources, such as oil, gas and coal, they still account for about 80% of the average global energy. Of this total, oil and gas account for over 50%. Many analysts forecast this situation will continue in the upcoming 30 years<sup>7</sup>. In Brazil, the dependence on oil is below the world average given the possibility of using large-scale hydropower.

Besides oil being a key element in the energy system, it also is an important raw material for other industries such as plastics, colorants, solvents, pharmaceuticals, etc.

For this reason, it can be said that the oil industry will continue to occupy a key role both in the energy matrix and in the supply of input for various industries.”

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<sup>7</sup> IEA World Energy Outlook 2015



## 9. CONCLUSION

In short words, we can take the following conclusions:

- We expect to have some papers published soon;
- The integration and effective joint work are being achieved by our members;
- Growing interest by other schools and professors to take part of the group;
- Co-teaching and joint work have produced a network beyond the limits of LSGL;
- In Chicago, we will have a separate meeting to discuss next steps.

Wanderley Fernandes  
Chairperson and rapporteur

São Paulo, July 4<sup>th</sup>, 2016.