the evolving role of GENERAL COUNSEL

A Roundtable Discussion

Keynote Speaker:
Dr. Beat Hess, PhD.
Group Legal Director
Royal Dutch Shell plc
TO THE READER:

The Global Energy industry faces pressure from all sides. Consumers rely upon an uninterrupted, inexpensive flow of fossil fuels but also expect the industry to provide cleaner, cost-effective alternatives. The desire to provide for the world's energy needs in a socially responsible manner while maintaining profits, controlling costs, and complying with tightening environmental and business regulatory schemes are just a few of the challenges facing the energy industry.

Royal Dutch Shell PLC responds to these often competing objectives through its aggressive exploration of conventional fuels to satisfy the world's energy needs today and its substantial investment in the development of greener alternatives for tomorrow. Charged with protecting Shell's dominant position in the market and ensuring its future success, Dr. Beat Hess, PhD., Group Legal Director of Royal Dutch Shell PLC, leads a legal staff of 700 attorneys to address these myriad challenges on a daily basis.

In this most recent of our ongoing GC Leadership series, we had the distinct pleasure of hosting Dr. Hess who provided perspective on the environmental and legal challenges faced by Shell and other energy providers worldwide, including: dealing with new technology; increased regulation and litigation surrounding carbon emissions; increased resource nationalism around the globe and local legal instability; and a greater emphasis on protecting intellectual property rights. Moreover, as with all of our Roundtables, Dr. Hess also addressed the qualities Royal Dutch Shell values and expects from their lawyers and external counsel.

The panelists, all of whom are respected partners in major law firms across the U.S., offered perspective from outside the corporation. Bruce R. Bilger, a Partner of Vinson & Elkins, provided an intriguing overview of the current trends within the energy industry, including a look at how nationalism is influencing the energy industry, the use of master limited partnerships, large utility mergers, renewables, and the use of wind and biofuels.

Marc S. Rosenberg, a Partner of Cravath, Swaine & Moore LLP talked about the complexities of corporate governance; the stock options investigations that were conducted in the last year; and the role boards of directors and lawyers should play going forward.

Edwin G. Schallert, a Partner of Debevoise & Plimpton LLP discussed three exciting developments in the legal arena, including the decline in new class action securities lawsuits during 2006; the impact of the recent Second Circuit decision in the IPO securities litigation; and, the court’s varied treatment of punitive class actions involving non-U.S. investors.

Finally, Ralph C. Ferrara, a Partner of LeBoeuf, Lamb, Greene & MacRae LLP, examined recent trends in the area of litigation and liability for corporate directors and their officers. He reviews key cases that have contributed to a recent shift in position.

The text of the panelists' comments, edited for clarity and brevity, follows. The views expressed are those of the Roundtable participants and not necessarily the views of the firms or companies.

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ALM Media, Inc.
Good morning. I’m Jack Friedman, Chairman of the Directors Roundtable. For those of you who are not familiar with the Roundtable, we’re a civic group that works worldwide with boards of directors and their advisors in roughly 20 countries and 30 cities in the United States. Over the years we have conducted over 600 programs, honoring the role of the general counsel.

We’re very pleased to co-host this event today with the National Law Journal. Our guest of honor today is Dr. Beat Hess, Ph.D., Group Legal Director of Royal Dutch Shell plc. I would also like to introduce briefly our four distinguished panelists in their order of appearance today: Bruce R. Bilger, a Partner of Vinson & Elkins; Marc S. Rosenberg, a Partner of Cravath, Swaine & Moore LLP; Edwin G. Schallert, a Partner of Debevoise & Plimpton LLP and Ralph C. Ferrara, a Partner of Debevoise & Plimpton LLP. Without further ado, I’d like to welcome our honoree, Dr. Beat Hess, who will be addressing amongst other issues today, the legal challenges facing the energy industry.

Shell believes that technical innovation will provide vital. Only through innovation will we be able to unlock more energy resources, produce and consume energy more efficiently, and substitute conventional fossil energy by alternative energy, such as wind, solar, and biofuels.

—Dr. Beat Hess

It is sometimes said that corporate communicators seek to create space for the business to move forward and corporate lawyers prefer to put up hurdles to block it. There may have been some truth to that in the past. But in today’s world, a good corporate lawyer creates space by anticipating future legal challenges, while the responsible communicators take into account that statements made today may be used in court tomorrow.

Before addressing the legal profession in the energy industry, let’s take a brief look at the broader energy challenge. Recent history is a good place to start. Let me take you back to the fall of 2005, when the Hurricanes Katrina and Rita damaged many platforms, refineries, power plants, and power distribution equipment in and around the Gulf of Mexico, shutting down about a quarter of U.S. domestic hydrocarbon production.

On the Friday after Rita, there was no power at any of the refineries in the region across the entire State of Louisiana, into Texas, down to Corpus Christi, and it was impossible to pump oil through the pipelines.

Fortunately, technicians managed to restore emergency power during the weekend. Imagine if they had failed, what could have happened. There might well have been panic buying at gas stations across the entire Southeast, and then spreading north to New York and other parts of the country.

The hurricanes reminded us of the big effect that a local supply disruption can have when global spare production capacity is limited, and the geopolitical situation is already tense.

Between 2000 and 2005, the supply situation had become increasingly tight because of rapid energy demand growth in China and India, and increased demand for fuel in the United States, reflecting, not the least, the increased number of SUVs in the U.S. car park. On the supply side, we felt the effect of low levels of investment in the 1990s.

Despite the relatively high oil prices today, worldwide demand is expected to remain high in the coming decades.

The International Energy Agency believes that energy demand could increase by around 50% between now and 2030. And world energy consumption by the middle of this century could be double today’s levels.

Huge investments will be required to make sure sufficient energy can be supplied. Again, the International Energy Agency speaks of a cumulative investment of around $20 trillion dollars (in 2005 dollars) over the period of 2005 to 2030, for the combined electric power, oil and gas sectors.

But supply and demand are only two dimensions of the energy industry picture. A third dimension concerns the emission of greenhouse gases, especially carbon dioxide. It is estimated that carbon emissions could rise by about 55% until 2030. The increased use of coal, especially in China and India, explains why carbon emissions rise even faster than overall energy demand.

And so the question will be, how to produce more energy and less carbon dioxide. Shell believes that technical innovation will prove vital.

And actually, here, I have a note in my script reminding me that I should have made a disclaimer statement before I start to talk. The note reads: Have you made a disclaimer statement? Well, I have not. You know, I was searching the Internet and I bumped into “disclaimer.com.” “Disclaimer.com” is a company that specializes in disclaimer statements. And when you open the webpage of “disclaimer.com,” of course, you’ll find a dis-
Meeting the energy challenge is our collective responsibility and Shell will continue to take its share of the responsibility. But we can only develop a healthy, sustainable business in an environment of good faith conduct, reliable partners, and respect for the rule of law.

—Dr. Beat Hess
The energy industry is not like your typical widget manufacturer or service provider. It is a highly regulated industry. Federal and state regulations provide significant constraints, but also offer opportunities for the savvy player.

—Bruce Bilger

healthy, sustainable business in an environment of good faith conduct, reliable partners, and respect for the rule of law.

Now, maximizing the business opportunities while mitigating legal risk will depend on how well we have prepared our lawyers and structured our services.

And so I ask myself, do my lawyers, both in-house and outside, have what it takes to meet the legal challenges presented by such a picture? Will they tomorrow? And how can I ensure they do?

The mandate of Shell Legal is to provide and procure top quality and fit-for-purpose legal and IP services to Shell companies in a proactive, timely, cost-effective, and professional manner.

In my view, one can only fulfill such a mandate by focusing, in the first instance, on the basics: structure and reporting, core competences, and relationships with external counsel, and a certain personal style. The rest will follow. And what do I mean by structure, core competences, and relationship with external counsel and style?

Let me first say a few words about structure. I’m a firm believer in the value of a well-structured law department with solid reporting lines within the function and clear accountabilities. A proper structure contributes to both the overall professional quality of the law department, as well as the quality and independence of the specific legal advice rendered to the businesses. Among other things, it reduces duplication, increases the timeliness of responses, maximizes cost-effectiveness, and is easier to manage.

With over 700 lawyers in Shell Legal, our ability to add value and fulfill our mandate would be severely restricted without our structure and the harmonization of roles and responsibilities within it.

The structure of the Shell legal function is a mirror of its business organization, where the lawyers and IP professionals are located and work hand-in-hand with their business clients, but have clear, solid reporting lines within Legal. They are geographically decentralized, but work within a number of defined minimum standards, such as a global legal budget, risk assessment policies, performance and development goals and targets, leadership guidance, and a talent development scheme. These minimum standards are contained in the Shell Legal and IP Frameworks, applicable to everybody in Shell Legal, and regularly updated on our Shell Legal homepages.

A common uniform approach towards a number of well-defined minimum standards written in plain, understandable language is, in my view, the glue that holds a large legal community together, and provides the salt and pepper for a distinct and, may I say, distinguished culture.

Within such a structure, I believe that mature, experienced lawyers should be leaders at the top; lawyers that can delegate their own responsibilities within their areas of competence, and lawyers who have, and that’s important, the ability to look beyond the day-to-day legal issues.

They should be complemented by lawyers who can concentrate on the core legal competencies required to respond to the needs of the business that they support.

The more senior lawyers also need to cooperate and integrate with top management of the businesses they support, including also, our Executive Committee and Board of Directors.

Given the complexities of the energy industry, the ability of lawyers to understand all of the drivers and pressures on the business is key to assessing, advising, and mitigating the legal risks, while maximizing opportunities for the business to move ahead.

Lawyers also need to be able to distinguish between essential matters and those that are simply nice to have. And just as importantly, they need to be able to coach and mentor their juniors to develop these same skills.

The focus on essential matters is particularly close to my heart.

Ladies and gentlemen, a risk-based approach is how we make the selection between the gold-plated Rolls Royce and the perfectly useful Volkswagen.

No doubt, we could do with fewer lawyers and less cost, if everybody throughout our organization, and particularly the leaders, possessed this valuable skill, which, in my view, distinguishes the good from the average. Namely, the skill to lean back and to spot relevant risks, current and future, and to guide our business people calmly through the choppy waters of today’s hazardous environment.

And something else: of course, we all look for high caliber, intelligent, good, solid lawyers. But lawyers also need to have a high emotional quotient or EQ. This enables them to communicate, interact, and deal with others without friction. And the others will not only include our business people, but also Board members, shareholders, regulators, government agencies, NGOs, other lawyers and so forth.

In a global business such as ours, there are already enough language, cultural, and other differences with which to contend, without having to worry about whether our lawyers will even recognize them.

And this is also important: I am, perhaps, an old-fashioned person, but I value lawyers with a minimum of manners, not overly friendly, simply friendly. And you know what? It doesn’t cost much.
Finally, backbone, determination and good judgment round out the core competencies of an in-house energy industry lawyer. Backbone and determination to take a position and enforce our rights, when required, and good judgment to know when this may not be possible, even in the face of clear rights; certain countries come to mind.

I would also like to say a word or two about the role of lawyers in the area of compliance. The energy industry operates in an ever-increasing regulatory environment. Energy industry lawyers can play a large part in providing proactive advice to avoid issues altogether, at least where the rule of law prevails. And even sometimes when it doesn’t.

We have considerably strengthened our internal compliance framework, because I believe that this will be an area of increased focus in the years ahead of us.

The range is wide, from antitrust to health, safety, and environment. Or take the complexities of disclosure rules, where often, within minutes, we have to give advice whether immediate disclosure of an event is mandatory, with potentially far-reaching consequences.

Let me now turn to a few thoughts about our relationship with outside counsel. And this speech is now going to last only about three more minutes, so stay with me.

In-house lawyers are only one part of the legal profession supporting the energy industry; external counsel is the other.

Maximizing the business opportunities while minimizing legal risk often requires that these two parts work hand-in-hand. And I believe there should be a good balance between the work done internally and externally. About half of our total legal budget spend in Shell goes to outside counsel.

In my view, the basic principles for good cooperation between in-house and outside counsel are trust, availability, and efficiency. We place a lot of trust in external counsel to provide an assessment of the potential risks and to anticipate issues.

In a dynamic and global industry such as ours, the ability of external counsel to foresee, prevent, or at least mitigate against future issues is very valuable. We trust that our advisers have done their due diligence and applied their best minds to our difficult issues.

This doesn’t mean that we expect to be advised of the safest course of action. But rather, that the risks and potential rewards have been properly considered and assessed, both with regard to the issue at hand, and in the bigger picture.

I, for one, choose individuals, persons, and personalities, as my outside advisers in the first place. The name of the firm, while not unimportant, comes second.

External counsel must also be available. And this means proper staffing, coverage during off hours, and absence of conflicts. It goes without saying that responsiveness is key. With operations around the globe, our workday never really comes to an end.

Efficiency is another foundation for good cooperation between internal and external counsel. Costs, of course, are a never-ending pressure. And we look to our external counsel to optimize resources and provide productive, competent, and capable lawyers.

There appears to be a constant struggle not to “over lawyer” a file. And I encourage my lawyers and external counsel to keep a critical eye as to what is required and what is not a must.

We also trust our external counsel to be professional, of course, and to work with our business colleagues in a focused manner, avoiding too much legalese and jargon, and providing pragmatic solutions. We expect a lot from our external counsel. But we also offer some of the most interesting and challenging work in the industry.

And so you now have heard some of my views on the legal challenges in the energy industry and how we are preparing ourselves to face them. Of course, other industries too will face such challenges, as the nations and the economies of the world continue to develop.

I’d like to close by saying that I thoroughly enjoy working in this particular industry and with all the people helping to move the business forward, including many of you here present today. Thank you for your time and attention.

MR. FRIEDMAN: Thank you Dr. Hess. Could you please tell us a bit about Shell’s beginnings and about how big it is in terms of its worldwide scope?

DR. HESS: In 2007 Shell will celebrate its 100th birthday. It has a long history in the energy and petrochemicals business. Today Shell employs over 108,000 people and is active in more than 130 countries. It consists of the upstream businesses of Exploration & Production and Gas & Power and the downstream businesses of Oil Products and Chemicals. We also have interests in other energy-related areas including Renewables and Hydrogen.

Total gross sales proceeds in 2006 were some $318 billion. Capital expenditure in 2007 is expected to amount to some $25 billion; most of it will be invested in upstream projects.

Shell Legal is comprised of over 1,000 people, including the 700 lawyers that I mentioned, and intellectual property professionals and support staff.
A board should not act as its own legal general contractor. And if a board finds itself mediating disputes between lawyers, something has gone wrong.

—Marc Rosenberg

MR. FRIEDMAN: Thank you for your comments. We appreciate it. Bruce Bilger of Vinson & Elkins will be our first speaker today.

MR. BILGER: Good morning. It is a pleasure to share in this occasion, honoring Beat Hess. Congratulations, Beat.

Vinson & Elkins has had the privilege of representing Royal Dutch/Shell on matters all around the world for many years. And I have personally had the opportunity to represent Shell and parties on the other side of Shell on a number of transactions. And I’ve got to say that I’ve always found Shell and its representatives to be sharp, reasonable, and of the highest integrity.

This morning, I’d like to visit with you about the energy industry, a truly exciting and unique industry.

First, the exciting part. Consider the volatile commodity prices that energy industry management teams have to deal with every day. Consider the personality and mindset required to invest $100 million in a hole down into the earth that may come up totally dry. Consider the reputation and skill of a management team that can raise $1.5 billion from private equity investors, based solely on a vision, and with no initial hard assets. And consider the technological skills required to supply the world’s growing demand for oil and gas. This picture is actually a 3D depiction of wells drilled under Long Beach, California, from you can see, a very limited number of surface well sites. And it’s a pretty cool picture, too. As you can see, these are exciting people to deal with.

And now the unique part. The energy industry is not like your typical widget manufacturer or service provider. It is a highly regulated industry. Federal and state regulations provide significant constraints, but also offer opportunities for the savvy player. And, industry terms and customs can make you feel like a fish out of water, if you don’t know what you’re doing. It takes a lot of experience to understand and provide value to the energy industry.

Vinson & Elkins has been focused on the energy industry for almost 100 years and for many years has been widely recognized as the world’s leading energy law firm. We have over 400 energy practice lawyers with significant expertise and experience in every sector of the energy industry, and in every geographic region of the world.

And now I’d like to touch on several recent trends and opportunities that we see in this exciting and unique industry.

As you can imagine, M&A is booming in the energy business, driven in large part by high stock prices, volatile commodity prices, consolidation cost savings, and divestitures of non-core assets. In particular, with more money on the buy side, and seeking limited product on the sell side, the sales process itself has changed dramatically over the last couple of years, providing significant opportunities to knowledgeable buyers and sellers, and providing disappointment to those not so knowledgeable.

Another trend; national oil companies now own or control about 80% of the world’s oil and gas reserves. And with the recent high oil prices providing significantly increased cash flow to invest, we’ve seen these NOCs taking their money abroad and acquiring additional oil and gas properties all around the world, to supply their domestic needs and to diversify their resource base. Also, focused on these relatively high energy prices, national governments, themselves, have been increasingly nationalizing and/or just grabbing a little bit bigger share of the economic benefits of energy assets away from companies. The disputes and settlement arrangements required to deal with these nationalization actions require substantial expertise in the energy industry, as well as, in international laws and treaties.

Master limited partnerships, or MLPs, are continuing to multiply. As many of you know, publicly traded partnerships can avoid corporate level income tax if more than 90% of their income is related to natural resources. Because MLPs are generally energy focused, our lawyers have represented, either as issuer’s counsel or as underwriter’s counsel, 67 of the 70 MLP IPOs that have occurred since the tax laws were changed in 1986. MLP investors generally expect stable cash flow growth. And thus, traditionally, MLPs have focused on the midstream gas sector. But in the last year, we’ve seen several MLPs come out in the exploration and production sector for the first time in about 20 years.

Large utility mergers, which were increasingly popular a year or so ago, lost a lot of steam this past year, when state regulators got greedy and the Exelon-PSEG merger and the FPL-Constellation mergers were both cancelled. The synergies available in these large utility mergers are significant, but it will take all stakeholders being much more reasonable in order to capture those benefits.

Renewables are obviously the current rage. Interest in renewables is driven by energy security concerns, as mentioned by the President last night, and global warming concerns, high fossil fuel prices, volatile fossil fuel prices, improving technologies, and the current relatively low cost of capital to fund projects. While only a small part of the overall energy supply today, renewables, and particularly wind and biofu-
els, have been growing at a significant rate. Twenty states now have adopted a renewables portfolio standard mandating that utilities in their area obtain a certain minimum amount of power from renewable sources.

I wish that I had time to discuss a number of other energy industry developments, including: the increasing use of volumetric production payments and hedging in energy debt finance; the increasing role of private equity and hedge funds in funding startup management teams and projects, as well as traditional LBOs; the current race among U.S. utilities to develop the next 6,000 megawatts of nuclear power in order to take advantage of significant federal economic benefits applicable to that next 6,000 megawatts; the transition in the LNG market from a point-to-point market to a global integrated LNG market, which happens to strengthen the hands of the majors like Shell; the increasing use and efficiency of natural gas storage facilities being developed around the country; and, obviously, global warming concerns and many others.

Suffice it to say that worldwide energy demand is continually increasing. And companies like Shell, who provide energy to us, have plenty of opportunities. Knowledgeable players in the energy business will continue to do very well.

Thank you.

MR. FRIEDMAN: Our next distinguished speaker is Marc Rosenberg of Cravath.

MR. ROSENBERG: Thank you. Good morning. Beat, it’s an honor to be part of an event honoring you. I was asked to talk briefly about corporate governance. And I thought it might be interesting to take a look back at all the investigations that were conducted in the last year, into stock option backdating.

I want to see if there aren’t some lessons that can be derived from the option backdating investigation experience that might have some resonance beyond backdating for the next crisis.

I can think of a few, and I’ll give you as many as I can get through before we run out of time.

The first observation is that the chicken soup rule doesn’t apply to corporate governance. What they say about chicken soup is, whatever your ailment, chicken soup might help and it certainly couldn’t hurt.

Corporate investigations don’t really fit that mold. Investigations are very costly and not just in dollar terms, but because they turn governance on its head. The people who are supposed to be standing back, having perspective and the big picture in mind, are getting into the nitty-gritty. And the people who are supposed to run the company aren’t running the company.

I think that one lesson, and Beat, you did touch on this, is that triage is an important part of corporate governance. Assess risks realistically. When it comes to options backdating, step one should have been, and usually was, to take a look at option exercise prices mapped out against market trading prices. If all your options were granted at quarterly lows, you’re probably looking at a soup to nuts investigation.

If none of them were, it’s perfectly appropriate for a company to say, we took a look and we see no reason to believe there was backdating at this company. And we don’t think it’s in the best interest of our shareholders to spend a lot of time and money on a wild goose chase. And so the chicken soup rule does not apply.

Lesson number two, which is really more of a question: how many lawyers does it take to change a light bulb?

In the rush to get to the bottom of backdating, before the U.S. Attorney came calling or before the Wall Street Journal wrote the next article, a lot of people rushed out and got somebody in and got started on their investigation using a former U.S. Attorney, a former SEC enforcement person; somebody very good and very qualified at investigating.

But before very long a question came up about how do we get our 10Q filed? What kind of disclosure do we have to make? What are the tax consequences?

And another lawyer would be brought into the boardroom, and then another specialist and another specialist. And then, finally, the board would have to hire another lawyer to coordinate all the other lawyers.

Obviously, this is inefficient and costly. But, I think, it’s also just a very risky proposition. A board should not act as its own legal general contractor. And if a board finds itself mediating disputes between lawyers, something has gone wrong.

Lesson three: I’m not really a director, I just play one in meetings.

Directors, under the laws of most jurisdictions, can get substantial protection by bringing in competent experts who have been selected with due care. But a lot of attention has to be paid to the line between where the lawyer’s expertise ends and
The Second Circuit held [that] the District Court could certify a class only after making the determination that each of the requirements has actually been met...[T]hose include numerosity, commonality, typicality, [and] adequacy of representation. Second, the court would have to consider all of the available evidence in making such a determination, and not simply the plaintiffs’ evidence.

—Edwin Schallert

The director’s responsibility begins. It’s the director’s job to make the hard business judgments. Lawyers need to present their findings and their advice in a way that doesn’t usurp that judgment. And directors need to be careful not to try and farm out to the lawyers the decision about what settlement offer to make or who to fire or not fire.

Backdating provided an interesting example of how hard it can be to respect the line between fact, which is within the province of the fact-finding expert lawyers, and judgment.

The critical issue for most backdating questions is, when was the option finally granted? And sometimes that’s quite obvious. Sometimes there’s a perfect set of papers that makes it crystal clear when that option was finally approved. But sometimes the paperwork is missing. Sometimes, the evidence and the recollections are in conflict. And sometimes the documents have been forged or altered.

And in those situations, the lawyer can’t answer the critical question, which is, in light of all the available evidence, what’s the most likely scenario? When was this option most likely finalized?

The lawyer needs to be careful to present the facts in a manner that carefully distinguishes between fact and judgment.

Lesson four, which I’ll call everything looks worse in black and white.

Boards should act on the basis of a press release, or some other summary document, and not on a grand concept, not on an abstraction. If you think about it, in the course of an option backdating investigation, if there was evidence that the CEO was aware of backdating, there’s an obvious question: should we fire the CEO?

But buried within that obvious question, which is so clear at 30,000 feet, are a host of more difficult and technical issues that arise as you get closer to ground level.

Who would take over if we fire the CEO? Would that person have option backdating issues of their own? If we fire the CEO, is it for cause or not? If it’s not for cause, are we going to have to also make and disclose a very large severance payment that is going to cause us some headaches? If it is for cause, are we going to spell out that cause in a public way, to the extent that class action plaintiffs will be salivating and pretty confident that they can survive a motion to dismiss?

You can’t really make that decision as effectively if you just talk about should we fire our CEO? Write it down. And spell it out the way that you would communicate it.

The other benefit of that approach, in this environment, is that while it’s important to get critical business judgments right, it’s not enough to get them right. You also have to communicate them in a way that you can persuade a large number of very skeptical constituencies that the judgment is sensible and coherent and the right thing for the shareholders.

And by looking at that press release, you have the opportunity to try and anticipate all those objections and make your best case. Because you’re never going to be more persuasive or more credible than on your first try.

Lesson five: Who’s minding the store?

When an option backdating investigation is going on, or a foreign corrupt practices act issue, or a financial statement restatement exercise, it’s easy sometimes, as independent directors start running the show, to lose sight of the fact that there’s a business to be run.

Somebody’s got to run the factories and sell the products and communicate with the employees and the investors.

There are times where management really does need to be held aside, while it’s determined whether they are culpable or not culpable. But boards really need to focus on getting the answer to that question as quickly as possible, and either reinstating management or replacing management as quickly as possible.

I said before that the chicken soup rule doesn’t apply to corporate governance. But the Pottery Barn rule does apply; you break it, you own it.

If the board isn’t going to let management manage, which is what management is good at and is paid to do, the board is going to have to do it.

Lesson six, please wait your turn.

Backdating investigations take a long time. Getting to the bottom of the issue and getting the facts takes months. If you compare that to selling a public company, it takes a few days for your investment banker to give you your fairness opinion.

It took, in many cases, weeks and months for investigators to assemble all the relevant facts, and get through all the emails, and interview all the witnesses.

Board members love to get interim updates. There are boards who met 20 or 30 or 40 times during the course of an option investigation. That’s not a good idea. It’s not just inefficient and a waste of people’s time, it distorts the decision making process.

The issue should be, in light of the totality of the facts, what do we think happened here? But if you reach a tentative conclusion a quarter of the way down the road or halfway down the road, the issue
But it is now clear in this particularly influential venue [the Second Circuit] that District Courts will need to give a searching inquiry before they’re going to certify any class actions.

—Edwin Schallert

is no longer what happened? The issue becomes whether what we learned today is enough to change what we thought we learned before.

And, of course, what we thought we learned before was on the basis of partial information. We were not fully informed. And yet, there’s now, effectively, a presumption that got created too early.

Juries aren’t allowed to deliberate until the case is done and the judge’s instructions have been received. Boards really need to be told or begged to wait their turn, and wait until the facts are in, before the real deliberations begin.

I think that’s probably all the wisdom that I can make up this morning. And so I will turn it back to Jack.

MR. FRIEDMAN: Thank you, Marc. Edwin G. Schallert, a Partner of Debevoise & Plimpton, will be our next speaker.

MR. SCHALLERT: Thank you. I’m delighted to be here, on behalf of myself and my firm, to honor our distinguished guest.

I thought I would talk about three particular developments. The first is the really striking decline in new lawsuits in the class action securities arena during 2006. The second is the recent Second Circuit decision in the IPO securities litigation and what it means. And, finally, the third is the court’s varied treatment of punitive class actions involving non-U.S. investors.

Let me start with the plunge in class action securities fraud filings during 2006. The annual cornerstone research report, which was based on the Stanford Clearing House data, shows that 110 class action filings occurred in 2006. That’s down about 38% from 2005.

The 2006 filings are 43% lower than the 10-year average since the adoption of the Private Securities Litigation Reform Act of 1995.

If you exclude the options backdating claims from the 2006 numbers on the ground that they’re unlikely to recur, the decline is even more striking, about a 50% decline. And that’s probably a more meaningful way to look at the numbers, since the historic data excludes similar one-off cases like the IPO allocation or the mutual fund market timing cases.

The 2006 decline was not limited to number of cases filed. The total losses in the cases as measured by market capitalization, also, declined significantly, although the size of the average case declined more modestly. I’ve included a summary chart of those trends in my handout.

Part of the explanation for the decline undoubtedly lies in the fact that the stock prices increased and volatility remained low in 2005 and 2006. This can be contrasted with the Internet bubble bursting and other events in the early 2000s, which sparked an unusual flurry of litigation.

But it may also be, although it is harder to prove, that companies are being more careful in their earnings announcements and forward looking statements.

Against this backdrop, a December decision by the U.S. Court of Appeals for the Second Circuit, which as you know is probably the preeminent appellate court for cases involving financial services, has now raised the bar higher for plaintiffs pursuing certification of class actions.

The opinion for the court, by Judge Newman, addressed an issue that the court noted was surprisingly unsettled in this particular circuit: what standards govern a District Court in adjudicating a class certification motion?

The court reached a couple of very important conclusions. The first was that a district judge may not certify a class without making a ruling that each requirement in Rule 23 is met. It would not suffice, as it has often in the past, for a plaintiff simply to make some showing or even some bare allegations, to try to satisfy each of the requirements.

Instead, the court held, the District Court could certify a class only after making the determination that each of the requirements has actually been met. As you probably know, for any class action, those include numerosity, commonality, typicality, adequacy of representation.

There are additional requirements for the most common type of class action under Rule 23(b)(3), which is a predominance of common law or fact questions over questions affecting individual members, as well as a finding that a class action is superior to other methods of adjudication.

For all of those requirements, the court will now have to make a specific finding that they’ve been met.

Second, another part of the decision by the court was that the District Court would have to consider all of the available evidence in making such a determination, and not simply the plaintiffs’ evidence.

And finally, this obligation to make this determination was not lessened even though some of the issues involved might ultimately involve issues going to the merits.

The District Court, after the decision, still has some discretion to control the extent of discovery in
The new Deputy Attorney General McNulty basically rewrites the Thompson Memorandum and says now there [are] not going to be penalties for non-waivers of attorney-client privilege, and you can fund counsel fees. [We are seeing a] tremendous retreat from this hard-lining by the Department of Justice.

—Ralph Ferrara
At that time, Enron and WorldCom were status breaking events, being that there had only been five cases of this kind, that is, five cases in 35 years, where directors had to reach into their pockets to pay. Now, did these cases spring like Athena fully-armed from the head of Zeus? No. There was a trail to it. That began sometime in 2000, I would think, with the Disney 2000 case, the Eisner compensation of Ovitz, both bringing him in and sending him out. And that very famous decision by a Delaware chancellor who said we are going to let this case go to trial and we are going to put those directors at risk. Because there was, we think, an allegation of knowing and deliberate indifference.

It struck people hard. That was followed by Oracle 2004, when the case went to trial and the Chancery Court in Delaware said, no, there was no trading. And we're going to put those directors at risk. Because there was, we think, an allegation of knowing and deliberate indifference.

It struck people hard. That was followed by Oracle at about the same time. That's where Larry Ellison at Oracle was alleged to have sold stock at a time when he was predicting growth and the stock price dropped off. Oracle's directors' found, no, there was no insider trading. The court says, no, this case is going to stand. And we're going to require that Larry Ellison stand trial in this case. And why? Because there was a “great,” I can't make this stuff up, "thickness of social relationships," between the board committee that was evaluating that Ellison stock trade, Stanford University and Ellison's contributions to Stanford University.

The Oracle case, we thought, got a little better in 2004, when the case went to trial and the Chancery Court in Delaware said, no, there was no trading. Only to find out in 2005 in a California case, that Ellison had to pay $122 million — $100 million to charity and $22 million to legal fees. It shocks the world.

At the New York Stock Exchange, we saw the Grasso compensation case. We were stunned, not so much that Grasso was sued, although it was remarkable, having raised the New York Stock Exchange like a phoenix, following the threat of Archipelago in the 1990s, to being the number one exchange in the world, only to be criticized for his compensation. But that was not the surprise. The surprise was Ken Langone, the head of the compensation committee, was thrown into that lawsuit as well.

And then there was, more recently in late 2005, the SEC decision to go after the Board of Directors. Well, go after, the staff says, they served a Wells Notice on the Board of Directors of Hollinger International, the Lord Black case, to account for themselves, in connection with a recommendation that the staff was apparently going to make to the Commission that those directors be sued. The trend continued in 2006 with Wells notices sent to directors of Mercury Interactive, where it's reported, the Commission staff is considering suing the directors in connection with their options backdating issue.

A remarkable thing when the SEC starts suing independent directors. Well, that's where the world was, and where the tectonic shift to the status quo post began.

Now I think, and people debate this, to me, it all began, and we hardly noticed it, back in August of 2005. Remember, I just said August of 2006 is when the shift became apparent? But you started seeing the ripple back in 2005. Where? In the Arthur Andersen case. Arthur Andersen, put down by the Department of Justice, indicted and the whole firm collapsed. The Supreme Court ultimately gets a hold of the case. And says, excuse me, the jury instructions were wrong. It did not give sufficient instruction on the conscience that is required to have an obstruction case. Arthur Andersen wins. Of course, Arthur Andersen has been destroyed. But the government takes a hard rebuke — hardly noticed at the time.

And then Disney comes back to us. Disney 2005, the very same Chancellor that said, those directors had to go to trial, holds a great trial. The Chancellor comes out at the end and says, in the most comprehensive decision on the duties of care, loyalty, and waste in the business judgment rule, I think, yet written in Delaware, he comes out with a ringing endorsement that these directors are to be “set free.” All right! They win. This coming from the judge who made them go to trial to begin with. After finding that, and this is the findings of the court in 2005, Eisner was Machiavellian. And that directors were, and these are the court's words, supine, passive, beholdng, kowtowing and sycophantic. Nonetheless, they prevail.

And now, I mean, let's face it, I'm a corporate defense lawyer, all right? For us, that is good news. Disney 2006, the Delaware Supreme Court grabs a hold of that decision and people are saying, is the Supreme Court going to really protect these kowtowing, supine, passive, beholdng, sycophantic directors? And the answer is, yes.

The Delaware Supreme Court affirms the decision and comes out with a wonderful decision, verifying the so-called raincoat provision, 102(b)(7), of the Delaware Code. And we have yet to understand fully how much protection that's going to give us. But the notion that bad faith in Delaware does not equal gross negligence, and we can indemnify for that, was incredibly good news.

And then, in what was reported to be the biggest tax fraud scandal in U.S. history, the District Court here in New York, Stein I, in two criminal cases in the
In a dynamic and global industry such as ours, the ability of external counsel to foresee, prevent, or at least mitigate against future issues is very valuable. We trust that our advisers have done their due diligence and applied their best minds to our difficult issues.

—Dr. Beat Hess

KPMG matter says, the government went too far. The government went too far. In Stein I, the Court says, they engaged in unconstitutional conduct when they kept KPMG from funding the defense of its present and former partners and employees. By doing so, they denied the employees and former partners and associates of KPMG the right to counsel, and accordingly, their confessions are suppressed. Remarkable decision! What does this cause? It causes reconsideration of the now famous Thompson Memorandum. Deputy Attorney General Thompson, a few years ago, writes a memorandum on when corporations can be indicted, right? And all of us stand in terror of it. It calls into question the Thompson Memorandum, to the point where just a couple of weeks ago, the new Deputy Attorney General McNulty basically rewrites the Thompson Memorandum and says now there are not going to be penalties for non-waivers of attorney-client privilege, and you can fund counsel fees. And so we see now this tremendous retreat from this hard-lining by the Department of Justice.

The shift continued. Bill Lerach, down at the Enron case, now gets nailed last month by the judge to pay legal fees for having brought, on a lack of merit, a case against Alliance Capital. And just a year earlier, Spitzer had to retreat from his pros-ecution in the Canadian Imperial Bank of Commerce case.

And finally, the IPO litigation, which Ed has described to you. That case, involving the class certification, which was a great win for corporate directors, I think, in the defense community at large. But also, in another part of that case, which is on its way to the Supreme Court, where the Supreme Court, and we’re not quite sure which way this one is going to roll, where the Supreme Court may give us some better help in the future on the relationship between the federal security statutes and the antitrust laws.

And finally, and I suppose, the last two cases that kind of give some hope to this tectonic shift, is the Frank Quattrone case. I mean, the relationship between the U.S. Department of Justice and Frank Quattrone from First Boston and the IPO investigations and so-called scandal, is a little bit like Ahab’s quest of the great white whale. Right? Tried, tried and let go two times, and they finally enter into a deferred prosecution agreement with Frank Quattrone.

And last, Mass Mutual. We have seen this whole long list of folks that have lost their jobs over options backdating and all other kinds of corporate scandals. Well, Mass Mutual, good’ole Robert O’Connell stuck in there. He was fired after his wife approached the Board with allegations he was having affairs with an employee. As I recall it, the ensuing investigation, the company found, as I believe was reported, irregularities in a “phantom” retirement account including hypothetical participation in IPO allocations. The arbitration award comes in last year and says, you corporate directors went too far. This fellow shouldn’t have been fired for cause. He’s entitled to $50 million of back pay.

And now, you put all of that together, all of this kind of coming out and peeking from under the covers, in August of 2005 with that Andersen case, and seeing this kind of wave building up to the middle of last summer, I think we’re seeing a shift — a shift that’s going to play itself out in the courts over the course of the next two or three years. And, hopefully, change the landscape of litigation and liability for corporate directors and their officers.

Thank you.

MR. FRIEDMAN: Thank you very much, Ralph. One of the issues that I’d like raise is that, as a multi-national company, you have to deal with the legal regime in many different countries, including the extraterritorial applications of American law.

We had a program in Paris, where the keynote speaker was the CEO of Société Générale. And he opened his remarks sharing how there company had given a loan from France to an industrial company in Iraq and then got sued in the United States for it.

And he said, I asked my attorneys, how can we be sued for something, which is entirely legal under UN sanctions and French law in the United States? And he said, I’ve learned, very well, the term, “deep pockets.”

And so I’d like to ask you and other panelists, your view of the role of American law for the multinational corporation. Dr. Hess?

DR. Hess: Well, actually, thanks for giving me the opportunity to say a few words about this question.

We are sued here over a number of issues that, in our view, have no connection whatsoever with the United States.

For example, it’s well known that we’ve been sued in this country over issues that happened 10 years ago in Nigeria. We don’t see any connection at all with the United States.

And what we see, of course, are plaintiffs who feel that it’s a bit easier to access deep pockets in the United States, than it would be in Europe.

And, it is no secret that three years ago, Shell had an issue with the categorization of its hydrocarbon reserves. We settled all of that with the SEC and the Department of Justice in a relatively quick and smooth way.

Yet that re-categorization of our reserves was, of
...[W]e’ve seen these NOCs taking their money abroad and acquiring additional oil and gas properties all around the world, to supply their domestic needs and to diversify their resource base.

—Bruce Bilger

MR. SCHALLERT: One of the challenges that the court faces in these cases is that anyone can file a complaint; historically, the standard for whether a case gets thrown out initially on a motion to dismiss, the court looks very favorably upon the allegations of the complaint. In effect, the court has to assume the allegations are true.

If it were possible to get rid of cases more readily on an initial motion, it would make life a bit easier when some of the particularly esoteric foreign plaintiffs’ claims are brought into the court.

And, fortunately, I think courts are reacting to that challenge by finding different ways in which they can go beyond the face of the complaint at the outset of the case, so that you don’t get a situation where a case that really shouldn’t be brought here is highlighted at length before being dismissed.

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MR. FRIEDMAN: Does anybody want to comment?

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MR. FRIEDMAN: Does anybody want to comment?

MR. FRIEDMAN: Dr. Hess, could you please tell us a
little bit about what you have done to change the governance structure between Shell's former parent companies and the regime that now runs the governance of the company?

**DR. HESS:** Shell used to have an English company and a Dutch company as dual parents. Both parent companies were independently quoted on stock exchanges. I always considered this to be a highly complex structure to manage. Prior to joining Shell, I worked for 27 years with a company by the name of ABB and I was their general counsel for 17 years. ABB had the same dual headed structure as Shell. And, I had always been told that you couldn't change a dual headed structure, mainly for tax reasons. However, finally, we managed to change that structure. We merged the two parent companies. It's a little bit more complex than that, but we made it a single company.

And, when I joined Shell in 2003, I felt that I should raise the subject of merging the two parent companies. And at that time, I was told you can't do it. It's not possible, for tax reasons.

Well, over the years, I have learned, my apologies to all the tax lawyers here present, I have learned not to believe absolutely everything the tax lawyers say and so I started to explore possibilities. Then came this issue with the reserves and the Boards of our two parent companies were more inclined to look at a merger-like combination. And so, eventually, we managed then to combine the two companies. Now we have Royal DutchShell plc, a single parent company incorporated in the UK, but headquartered and tax domiciled in the Netherlands. It is one parent company with one Board and with one Executive Committee.

Needless to say that this was from a legal perspective, a very, very challenging exercise. I think that nobody today regrets that we have streamlined that structure.

**MR. FRIEDMAN:** This next question is for any of the panelists. One of the big issues right now is Wall Street's role in the world capital markets. When you have foreign companies that are doing significant business with the U.S., what do you find are some of the big questions or issues that you have to educate them on?

**MR. BILGER:** Certainly, foreign companies usually require significant education regarding the U.S. capital markets. Registration on Wall Street requires compliance with our significant disclosure requirements, our financial accounting standards, and our ongoing financial and operational requirements. It also increases the potential exposure to liability over here, as we talked about earlier.

**MR. ROSENBERG:** I would agree with that. And I think there's an especially high level of concern and skepticism about Sarbanes-Oxley right now. Section 404 of the Sarbanes-Oxley, in particular, is an item that a lot of foreign issuers are very concerned about from a cost perspective and from a red tape perspective.

Ralph talked about trends in litigation. And I think on the securities and finance side right now, it is a much tougher sell than it was five years ago, to persuade non-U.S. companies that the U.S. is as attractive a market as it used to be for raising money.

**MR. FERRARA:** I might add to that by saying that perhaps, one of the most difficult questions that I am asked is, how do I get out?

By that, I mean, if you are Puerto Rico and you want to become a state, you can go to the Constitution and figure out exactly what you have to do to get there. If you are Florida and want to get out, you can go to the Constitution and it says nothing. You cannot go. We fought a war over that. All right!

Well, if you register with the Securities and Exchange Commission and list your securities there for trading, you can go through a mound of regulations that get you there. But you cannot get out. All right!

Now, the SEC has tried to deal with that, and they have relaxed the rules a bit. But you try to explain to a potential foreign private issuer, whether they should become such, and what the consequences of that are, and the lack of the liquidity out of this market, and then you understand why the Committee on Capital Markets recently wrote that of the 20 largest global IPOs, one was done in America.

What I think we are seeing is — until corporations of international scope can answer the question, how can I get out, at the end of the day, if I do not like it — we are going to ruin ourselves here.

I mean all of these companies, the Shells of the world, came to the United States. And they were told, when they listed on our markets, you have got to disclose. Everybody bought into the disclosure regime. And they all said, we can live with transparency. But nobody told them that Sarbanes-Oxley was going to be passed regulating the substantive conduct — that is, the normative conduct of what is a good or bad corporate officer director. And nobody signed onto that, and yet, you cannot get out. It's a big problem for international companies.
MR. FRIEDMAN: On cultural issues, when we do a program here in the United States, typically, the partner says, I want to do the program, but leave me alone and talk to marketing or their program people. When we try to do a European program, or a series in two or three countries, a British law firm we were working with said, we sent a note for a telephone conference inviting 35 partners in three countries to be on the line. And I said, what is this difference? And they said the difference is in Europe everybody feels that they have to approve things. And so everybody wants to be involved. Whereas, the Americans say, it’s inefficient for me to be involved; just leave me alone, I have my other more important matters.

What is the cultural difference between the way that Americans and the way that Europeans, or if you want to mention a particular country, actually operate and make decisions within the legal field?

DR. HESS: Well, actually, I think the difference is less and less. That’s the good part of it. Certainly, if you look at European boards, to take one example, we have imported a lot of good things over the last few years from the trends in corporate governance, and that started in this country.

I remember, years ago, when I was a secretary to the board of another company, and I don’t mean this in a particular negative way. It was a company based in Switzerland, and these boards were often composed of people who had a friend in the other board. And because the friend was on the other board, s/he became the member of this board.

It was a network of board people and corporate governance was nowhere, frankly, nowhere. One of the important topics was when and where do we have lunch? Or how many stars does our hotel have? And so forth.

Really not hard, serious board work. I must say that. I have witnessed many board meetings that in today’s world would simply not be acceptable.

I think that we have seen a lot of changes and those changes came because of the pressure that came not the least from the United States. I think that’s a good trend.

Today, of course, you have rules and regulations on corporate governance in most countries in Europe that are modeled and based on U.S. governance concepts — a most welcome change.

Are there differences? Yes, there still are, of course, differences in how you do your legal work in Europe. And differences in how we go about litigation, as you all know.

MR. FRIEDMAN: For example?

DR. HESS: Well, for example, you don’t have jury trials in civil matters and you have to put up your own funds, if you want to go to court in most, if not all, European countries.

So you do have a risk. You don’t have contingency fees and, you have to pay the other party’s lawyer’s fees, if you lose on trial.

These are significant hurdles that we think keep us away from overly frivolous litigation.

MR. FRIEDMAN: One of the big things we see in the energy industry is that every time the industry gets into a period of prosperity, it gets criticized for making too much money. People want to undo the deal and make a new deal. And my question for both of you is, how do you deal with the fact that people say, well, sorry, you’re making too much money; we want a bigger piece of the action?

MR. BILGER: It certainly is an issue that we have seen over the years, particularly in the emerging markets. Venezuela is currently the most prominent example of a government trying to change the economic deal that it agreed to when it appears that the private sector companies are doing better than expected, but actually many countries around the world are trying to renegotiate deals in light of the significantly higher oil and gas commodity prices we have experienced in the last few years. And, of course, we are not pristine in this area either. Several years ago, during the California energy crisis, California signed a number of long-term power purchase contracts and then, when prices turned, it forced power suppliers to renegotiate to terms more favorable to California. And now we’ve all heard about oil and gas leases in the Gulf of Mexico that the Federal Government now wants to renegotiate because of an alleged mistake.

I think that it may have something to do with Beaz’s 45,000 gas stations all around the world getting the attention of the population with large signs increasing prices from $2 to $3 per gallon. But, it certainly is something that, as developers of projects and as initiators of transactions, we always want to be careful that there is economic substance behind something and that there is a demand for a particular project.
rather than just a contract that a government signs or a party signs that it may elect to change when the situation changes.

**DR. HESS:** Well, of course, it’s a big concern to us. For example, very often we invest billions of dollars on the basis of so-called production sharing agreements where we take the initial risk of investing into exploration and production activities.

Then, on the basis of the production sharing agreement, we recuperate our investment in later years by taking a share of the production. And now, of course, if, after the investment is done, a government tells you that it doesn’t like the production sharing agreement anymore, the government really takes away the basis upon which you trusted, that your investment would be on solid grounds.

If you suddenly lose that basis, it gives you a signal and particularly, if this becomes a trend around the world it suddenly starts to shake the very foundations of your future business.

**MR. FRIEDMAN:** Without necessarily speaking about your company, although you’re free to do it, how are such conflicts worked out?

**DR. HESS:** The board is, of course, aware and regularly informed of all major issues. But, indeed, these are matters for executive management to consider and to decide. No need to say that Legal is always intimately involved.

And now, of course, if, after the investment is done, a government tells you that it doesn’t like the production sharing agreement anymore, the government really takes away the basis upon which you trusted, that your investment would be on solid grounds.

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**MR. FRIEDMAN:** Thanks. On lighter note Dr. Hess, what are your hobbies or interests or your idea of a good vacation?

**DR. HESS:** My hobbies, okay. As I mentioned in my presentation, I’m a child of the heart of the Swiss Alps. I grew up with a 10,000-feet high rock in front of my parent’s house. That’s why people often say that explains why I can be stubborn from time to time.

The mountains are part of my life. I like to ski and I like to mountain-bike. But I also I like to play tennis. I like music, classical and jazz. I have a lovely wife from Latin America and so, I like Latin American culture as well.

I met my wife when I was at university in Geneva. I wanted to help my father to finance my studies. So I opened a bar at the university campus. I was selling beer, together with a friend. And it became very successful. And, one day, my wife came from Latin America to attend a Swiss school. And, she showed up at that bar…

Any further details that you would like to know…?

**MR. FRIEDMAN:** Does any else have a question? It’s hard to top that.

**DR. HESS:** Before you all leave, let me just thank you from my side, for coming here today. I wasn’t really sure whether there was any reason for an honoring event. I always felt that, if I have one strength, then it was to surround myself with people who are much more intelligent and much brighter than I am. And these people actually deserve the honoring today. Thank you.

**MR. FRIEDMAN:** On behalf of the roundtable and the National Law Journal, and the ACC, I want to thank all of you very much for speaking with us today.

—Dr. Beat Hess
Dr. Beat Hess (J.D., Ph.D.) became Group Legal Director of Royal Dutch Shell plc in 2003. In this post, he has coordinated the company’s legal response to the challenges that arose for Shell following the reserves crisis in 2004, leading to successful settlements with various regulators. He also oversaw the legal work for the unification of Shell’s former parent companies, Shell Transport and Trading and Royal Dutch Petroleum Company, leading to significant improvements to the Shell Group’s governance structure.

He is Chairman of the Planning Committee of the European Chief Legal Officers Roundtable and a Member of the International Panel of Distinguished Neutrals (Arbitrators). He was awarded the International Education (United Nations) 1975 Fellowship Award for Outstanding Academic Achievements. Dr. Hess holds law degrees from the University of Geneva and the University of Miami, as well as a Law Doctorate (PhD) from the University of Fribourg in Switzerland.

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