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PRACTICUM: FORM AND POLICY

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The Impact of the United Nations on International Private Law, Trade and Development

Editor's Note: The following is an edited transcript of the presentations made at the Annual Meeting of the International Law and Practice Section of the NYSBA on 24 January 2007.

I. Welcoming Remarks

CALVIN A. HAMILTON: Thanks for coming. We have got what I think is going to be quite an exciting program. We have three different areas of U.N. institutional presence here. Indeed, this entire presentation came about because we thought we needed to push back on some of the knocks that the U.N. has received over the last few years.

We thought we should get some of those institutions within the U.N. that actually do the work and that we actually need as we go about our business, which is among other things, international trade.

Without ado, I'm going to turn this panel over to Deborah Enix-Ross, who will deal with WIPO issues and domain disputes.

Now just a little about Deborah. Deborah is a law graduate of the University of Miami. She is presently with the law firm of Debevoise & Plimpton, and she is also the chair of the International Practice Section of the ABA.

On Deborah's left we have someone who is very familiar to us, Gerald Ferguson. Gerry is a partner, as you all know, at Baker Hostetler.

And on Deborah's right we have Peter Michaelson, who is with the law firm of Michaelson & Associates. Peter has been in private practice for over 27 years now. He is also an arbitrator of domain disputes. I think he is also a fellow of the Chartered Institute of Arbitrators out of the UK.

Without more ado, I'm going to turn this over to Deborah. Thank you.

II. WIPO: Domain Names Dispute Resolution

A. Background

DEBORAH ENIX-ROSS: Thank you for inviting me.

As Calvin mentioned, I am the chair of the International Law Section of the American Bar Association. Calvin and I have known each other for years in that capacity. So it is a real pleasure and a privilege to be here at your International Law Section meeting. And I do hope that those of you who are interested in learning more about the ABA International Law Section that will come up to me afterwards. So that is the last plug that I will make for my Section.

We are going to talk about a procedure established by the World Intellectual Property Organization (WIPO), Arbitration and Mediation Center, commonly known as domain names dispute. I will lay the foundation for why this procedure was enacted or why it was felt that it needed to be enacted. I do have a bit of insight, as I was a lawyer at the Center at the time the procedure was established and was there for four of five years at the beginning of the procedure. So perhaps I can fill in some of the gaps with some inside information.

Then what we will do is have Peter discuss the procedure, how it works from the perspective of a neutral person, an arbitrator, if you will. And then Gerry will talk about whether or not the procedure works in every situation, or whether or not you should use other means to resolve trademark disputes. So we hope with that you will have a good idea of the value of this procedure and a good understanding of it.

I do want to say that I only intend to speak briefly to lay the foundation. Gerry and Peter will then follow. We will take questions after that. But we would also like this to be more of a dialogue, more of a discussion rather than a lecture. So that means if at any time you have a question and you can't hold back until the end, then feel free to ask as we go along. I think that will make it much more exciting and engaging anyway.

The Uniform Domain Name Dispute Resolution Procedure went into effect in October 1999. WIPO was the first accredited service provider. The WIPO Center was the first to receive a case. WIPO is one of four centers around the world that provide this service.

What is the purpose of WIPO and why is it needed? Well, you have to remember that, back in 1998-99, there was an explosion in the use of domain names. There was a time when most businesses, frankly, ignored the Internet, didn't feel that it was necessary to do business there. Slowly they began to realize that their customers were searching for them on the Internet.

I think most of us will remember hearing about cases where some smart teenagers in the early days gobbled up a bunch of domain names. Then when people like Coca-Cola or Microsoft, a company like that went to register its domain names, they found they didn't own them and had to buy them. Probably in the first instance when someone sold a domain name back to a major company for $5,000, we all thought it was cute. But cute only lasts when

you're three. When you're 18, it is not so cute anymore, as I tell my son.

So what trademark holders realized is that a domain name is a very valuable piece of property. You can only have one domain name. There can only be one www. Coca-Cola.com, and only one entity can register that domain name. So as you can see there is a conflict.

In the very beginning people could register hundreds and in fact thousands of domain names because, under the procedure that was set up, you didn't even have to pay the registration fee for months. So ideally, you could register lots of domain names, wait for people to recognize they wanted them, and you could have a good business selling them back.

Trademark holders began to realize that, if you were walking along the street, you wouldn't expect a McDonald's sign on a shop that wasn't McDonald's, so why would you expect to go to a domain name that didn't have any connection with a trademark holder? That was the backdrop.

There were of course people who felt that the Internet was a free and open space; they had an "anything goes" attitude and questioned why the Internet should be restricted. So you have these two competing interests. It was decided that there should be a procedure in which trademark holders could regain their domain names. It is important to recognize, however, that the procedure was designed to address a specific category of behavior, one known as bad faith. So if you could show that you had a legitimate reason to own a particular domain name, then your claim would be upheld, and the claimant would not be able to get the domain name back. I think that this is an important aspect.

So the procedure was developed. It is a mechanism to resolve disputes arising out of bad-faith registration and use of Internet domain names. The remedies are limited to the transfer or cancellation of the domain name. You cannot use this procedure to get any kind of monetary damages, any kind of punitive damages. Generally speaking, originally it was limited to domain names having the suffix .com, .net, or .org, because these were felt to be the most commonly used types of domain names on the Internet.

It is a very simple procedure. There are three elements to be proven. If you are the trademark or service mark holder, you have to prove that the domain name that you are seeking is identical or confusingly similar to your trademark or your service marks: that is one element. Second, you must prove that the respondent has no rights or legitimate interest in the domain name. And, third, you must prove that the domain name has been registered and used in bad faith. So it seems like a very simple and straightforward procedure. That is what it was meant to be. But as we will find out, each of these elements now has a real body of law that has grown up behind it. Keep in mind, you have to prove all three, and that is really important. I think Peter will discuss that a little from the perspective of the arbitrator. So there you have it.

It is a procedure that is done all on paper. It is submitted electronically. The respondent has a period of time to respond electronically. Arbitrators or neutrals are appointed. They review the documents that they receive, and then they make a decision about whether or not the domain name should be transferred or cancelled or whether it should remain with the respondent. So in a nutshell, that is the simple procedure. As we all know, things that are meant to be simple aren't necessarily so. Let us find out why.

B. Overview of the Domain Name System

MR. MICHAELSON: First, before I jump into the presentation, I want to thank Deborah for inviting me. I've had the privilege of working with Deborah for a few years while she was at WIPO, and she is just terrific. I was a bit forlorn when I learned she was leaving her position because I would lose this wonderful working relationship I had developed with her. But I was delighted when she came back to Debevoise. It is a pleasure to work with you, and even for a short time here.

What I would like to do in my presentation is start out with a very simple explanation of what the domain name system is all about and why it is so important on the Internet. What does it do? Then what I would like to do is talk about the WIPO process, what it involves. And then lastly, I would like to add some comments for you as advocates from the arbitrator's perspective. Because if you find yourself in one of these cases as an advocate, you may be able to take steps to heighten your chances of winning it. I characterize my comments as pet peeves of an arbitrator. My views are pretty widely held by my colleagues there. I think there are some 400 or 500 of us WIPO arbitrators.

So let me begin. This is the domain name system; it is a very simple system. But let me amplify a few things. The Internet dates back to the 1960s. It was started under the Defense Vast Research Projects Administration for Dartmouth. It was designed to be a means of communication in the event of a large-scale outage after nuclear attack. That is its genesis. For many, many years, even decades, the Internet was an academic tool. It was a network to connect many computers. But the problem was that, when were you sitting at one computer and you wanted to talk to a machine somewhere else, you had to know the command language of the computer you were talking to. And because the machines were different and operating systems were different, it was difficult to use. When I was an engineering student back in the early 70s, I was one of its users.

It was not designed for and could not be used by the public, because it was just so complex. What really exploded the use of the Internet in 1990 was the notion of a web browser, called Internet Explorer. For all of you that use it, the earliest incantations came about from the University of Illinois, called Franklin Mosaic, which later became Netscape. That made it very simple because that introduced the medium of point-and-click and eliminated the need to know the operating language of the machine.

The domain name system plays a very integral role because every computer is uniquely addressed; that is how you talk to a machine. And there are millions of machines on the Internet. Each one is addressed by virtue of what is called an IP address. You may have heard the term. An IP address is a sequence of four groups of three digits. I don't know about you, but as I approach my mid-50s, I can't remember numbers worth a damn. So if you're going to ask me to remember sequences of numbers to get to computers, forget it. So thankfully, a couple of decades ago that problem was realized, and consequently, domain names came into being. All a domain name is, is a construct that gets translated into an IP number. That action is extraordinarily important, because without that system the Internet will not function at all. It is key.

This process is administered by a group called ICANN, the acronym for Internet Corporation for Assigned Names and Numbers. This is the way it works: when you type in a domain name at your computer, your computer sends a request into the domain name system requesting the IP address for that domain name. When you type in debevoise.com or any other domain name, the computer doesn't know what to do with it, so it asks the domain name system to translate it. There is a hierarchical organization of domain name servers, and I won't get into the details of it, but suffice it to say your computer sends a query to these computers and it gets the IP address back. When it gets the IP address back, your computer knows what to do with it and then it sends its communication out to whatever server you want to communicate with, such as the one associated with the New York State Bar Association. Without this, the Internet fails. So it is a very, very crucial component.

C. WIPO Dispute Resolution Procedure for Domain Name Disputes

MR. MICHAELSON: Let me go into the WIPO process now. The way it starts is with a person filing a complaint. Anybody can initiate a proceeding. There are three criteria that you must comply with. Once the complaint is filed, the WIPO and National Arbitration Forum and others will then review it to make sure it complies with the formalities, make sure the domain name is registered with the registrar you said it was registered with, and so forth. If it doesn't, the complaint will bounce back to you to be corrected. At the same time, once a complaint is compliant, it is what we call "notified" to the parties. It is a very simple process. This is a typical WIPO complaint, and it is notified in several different ways: by e-mail, fax, and courier. The idea is to effectuate actual notice. If this notice is made by these three ways, it is deemed under the rules and policy as sufficient.

Once this notice is sent out, the clock starts ticking: a twenty-day clock for the respondent to reply. Now fortunately, all these forms are on the WIPO web site, so you can find the forms of complaint and response. So if you have one of these cases, it is very easy to put the forms together. In a response, the respondent has a chance to refute whatever is in the complaint. IN most cases, there is no response: in fact, 80 percent of domain name cases result in defaults.

Domain name cases can be decided by a one- or a three-person panel. The choice is up to the complainant and the respondent. The complainant in most instances chooses a single-person panel, but we arbitrators see it cycling back and forth between one- and three-person panels. The respondent has the option of either going along with a one-person panel or requesting a three-person panel. And if the respondent chooses the latter, then the parties split the filing fees. If the complainant chooses a three-person panel, the complainant pays the full fee of the panel. And the fees are a couple thousand dollars. We the neutrals don't get much. We get about half of that fee.

When we are nominated, we neutrals fill in a form called a Statement of Acceptance and a Declaration of Independence, in which we state that we have no conflicts, or, if we do have a conflict, we disclose it. It goes back to the Center, and if there is a conflict, the Center determines whether we should serve or not. The Center takes a very strict view of conflict. Thus, if we disclose even the least amount of conflict, they will pick somebody else. In my view, that is the proper thing to do.

Once the case is sent to us by the Center, a fourteen-day clock starts ticking. We have fourteen days within which to render a decision. All the decisions are published. Because I'm an extremely busy practitioner, I need more than fourteen days. Thankfully, the Center and all the providers are lenient and will generally grant a two-week extension.

Once the decision is sent back to the Center, the WIPO Center itself goes through the process of reviewing and editing it for editorial consistency. Then it is notified to the parties; that is, it gets sent out. And it also gets published on the WIPO domain-name Web site. The decisions are public. I don't know if the WIPO decisions are stored in any other repository, but I know the National Arbitration Forum decisions can be found on Westlaw. WIPO and the National Arbitration Forum are basically the two largest providers in this country, splitting about half the market.

The publishing of the decision sets off another clock, and the time period here is ten days. The aggrieved party (that is, the loser) may "appeal"—and I put the word "appeal" in quotes because the way in which you appeal is that you file a complaint in federal court for de novo review. What happens there is that the federal court will proceed with the litigation, but what happens in terms of the domain name itself is that the registrar, who has received a copy of this decision, will not implement it. So the point is, if there's going to be an appeal or de novo review, it has to be filed within ten days of the decision, and a certified copy has to be given to the registrar. If you do not do that within ten days, the domain name gets transferred if that is what the decision calls for.

There are three elements that you have to prove in a domain name case. The first is that the domain name is identical or confusingly similar to a trademark. This is crucial because, if you do not show that you have trademark rights by virtue of a federal registration, a state registration or at common law, you have no recourse. It is a threshold criterion that you must meet. There have been a number of complaints dismissed because the complainant could not show valid trademark rights.

Therefore, if you have one of these cases and are uncertain, you should certainly consult with a trademark attorney, someone who can really assess the situation. Make sure you have proof of the trademark rights. That's crucial.

The second element to be proved is that the respondent has no rights or legitimate interests in the domain name. The problem with proving this second element is that the evidence typically lies with the respondent. The claimant makes the allegation but has no proof. What we do as panelists frequently is to put the burden on the respondent to come forth and prove to us that it does have a legitimate interest. That will shift the burden. The evidence lies with the respondent, and the respondent is not going to give it up, obviously. There is no discovery in these cases, so we shift the burden and put the respondent to the task.

The third element to be proved is that the respondent registered and used the domain name in bad faith.

As noted above, all three elements must be proved. I will now briefly review each of them.

First, with regard to trademark rights, a U.S. trademark registration is prima facie evidence of validity. Persons serving on the panel do not pass on questions of validity. That is left to the intellectual property lawyers. A complainant must prove any trademark rights at common law. And if they are common law marks, one would need to show that they are used in commerce and that any descriptive marks have acquired secondary meaning. Let us take the example of the domain name "scubadiving.biz," a common name. Let us assume that the name is affiliated with a magazine entitled *Scuba Diving*. Because this is a common descriptive name, a claimant would be hard-pressed to claim any trademark rights in it.

We also have categories of domain names that are referred to as "typo squatting," which take advantage of a user's mistake when it is typed into a browser. An example would be the domain name "ElectronicBotique": as a result of intentional misspelling, a "u" is omitted. Another example is a domain name containing the word "0xygen": the number zero is used instead of the letter "O." These intentional misspellings result in domain names that are confusingly similar to domain names containing the correctly spelled words. It is preying on people who make mistakes as they type. Another example would be "Banes & Noble" for Barnes & Noble, leaving out the "r." All of these would qualify as names that are confusingly similar. Let us take a different kind of example: "McDonald's sucks." This would be a domain similar to the "McDonald's" domain name but including a pejorative term. This is a very common occurrence. There have been many similar cases. Sometimes it is a legitimate use because people are using it to criticize, and sometimes you have such a site because the party is attempting to take commercial advantage and basically use it as a vehicle to extort money from the trademark owner. A person creates a pejorative-sounding domain name and basically tries to sell it to the true trademark owner for what might be characterized as ransom. This involves the issue of bad faith.

Now let us turn to the element regarding whether the respondent has a legitimate interest in the domain name. There are three ways for the respondent to prove this. First, the respondent can show that it has made demonstrable preparations to use the domain name. This is a very, very specialized focused area of trademark infringement: more than that the mark is being infringed must be proved. Second, the respondent may show that it is known by the domain name (even if it has not acquired any trademark or service mark rights). Third, the respondent may show that it is making a legitimate non-commercial or fair use of the domain name. This is where the pejorative-term sites typically fall since they are sites used for criticism. This is a non-exhaustive list. An example of a legitimate interest case is "Ken Cole." That is a person's name and he is using it as a domain name.

With regard to the element of bad faith, this would be triggered when a party offers to sell a domain name at a price in excess of the cost of registration. When a respondent does this, it looks very bad to the members of the panel. The respondent is preventing the trademark owner from using the name. In other words, if you register the name and prevent the owner from using the name in its business, it can be a showing of bad faith. You are going to disrupt the business of a competitor, as the owner of

the mark, or you are attracting Internet users through confusion. In other words, you register a name and are trying to divert to your site users who want to go to another site.

WIPO provides some very useful tools, the overview of the UDRP decisions on its Web site. In the remaining time I have, I would like to talk about some pet peeves of mine.

Let us turn to some tips for winning one of these cases. First, these cases are very compact in time: they take sixty, ninety or one hundred twenty days, that is it. They are like motions for summary judgment. You load everything into your complaint and send it in. That's basically the only chance you have. Some providers allow supplemental filings, and I will address them below. This leads to a problem: as an arbitrator, I get pleadings that are ten, twenty, or thirty pages long, together with huge appendices. We as arbitrators are paid flat fees and are paid about a thousand dollars to read only a simple case. I really have problems when people send me huge amounts of paper. So I would like to take an attorney by the scruff of the neck and say that I get the picture. There was one instance where dealing with a case for a large New York–based insurance company claiming it had used its trademark since about 1910. Thinking they would impress the arbitrator, counsel included a specimen use for every year since 1910. That was crazy. But they threw in everything but the kitchen sink. So, please resist the urge; give the arbitrator the best evidence you have, and do it just once.

As to supplemental filings, the WIPO rules are silent. The National Arbitration Forum provides for them. Although I read everything that comes to me, I generally have found that supplemental filings are useless. They only afford counsel an opportunity to echo what he or she has already said. So, I urge you once again to say it once, and it will be understood.

Oftentimes a respondent requests the panel to invalidate a mark. The panel does not have the authority to do that. It can only cancel or transfer the domain name or dismiss the complaint, that is all.

As a panelist, I have never understood why anybody would want to have a domain name canceled. It makes no sense, so I suggest you not ask for that remedy. It puts the domain name back into the public domain for the losing party to go back and reregister and starts the whole process over again.

My last comment concerns the question of whether to choose a one- or a three-person panel. For most domain name cases, it is more or less a slam-dunk situation: If you have a very good case, ask for a one-person panel. It is cheaper. It will get the job done. If you have questions of law or questions of fact that you really are wrestling with, please ask for a three-person panel. But a three-person panel costs twice, sometimes three times what a one-person panel does. Thank you.

MS. ENIX-ROSS: Thank you. And I was remiss. I should have at the very beginning thanked Peter for stepping in at the last minute.

I would like to amplify a couple of points that Peter made. I hope it is clear to you that the decision is directed at the registrar. So when a person registers a domain name, that person agrees as part of the agreement he or she signs that, if anyone challenges his or her right to use that domain name, he or she automatically agrees to submit to these procedures. This is part of the registration process. A person registering a domain name must agree to submit to this procedure in order to register the domain name with any of these registrars.

The decision is directed not at the respondent, because again, half the time we don't know where that person is because often false information is given. The decision is directed at the registrar. If the registrar receives a decision from WIPO or NAF or another center stating that a domain name must be transferred or cancelled, as Peter indicated, there is a ten-day period during which the registrar waits to see if there is going to be an appeal. If there is no appeal, the cancellation or transfer becomes automatic, that is, the domain name automatically transfers or automatically cancels. And that is the reason why the system works. We are not relying on a respondent to comply with the decision; rather, the registrar must comply with the decision.

Certainly, during the question-and-answer period, I am sure there are things that you will want to ask about, but for now we'll turn our time to Gerry so he can tell us whether or not this procedure makes sense.

MR. FERGUSON: Thank you very much, Deb. And I do want to thank Peter Michaelson.

I personally found, as a practitioner, his arbitrator pet peeves very useful and making the audience, if no one else does, heed them. I'll see if I can pry some more pet peeves out of him during the question-and-answer period.

Echoing some of the points that Deborah made at the beginning, I do think that the WIPO procedure is an example of where the U.N. has provided a tremendous service to the world business community in dealing with a problem that is inherently an international problem. When you upload content on the Internet, you are immediately in an international environment. Yet at the same time there are still problems that cannot be fixed in our current setup of nation-states under an international regime.

So using U.S. law as an example, I think it is useful to explore what the differences are between trying to

solve your domain name problem in U.S. federal court as opposed to taking advantage of the Uniform Dispute Resolution Procedure, affectionately called the UDRP by practitioners.

Assuming this is a general interest audience, I would like to begin by focusing a bit on some of the fundamentals of U.S. trademark law. I am going to go over this pretty quickly, but I think that the important thing to understand about trademarks for the purposes of domain name litigation is that there is a spectrum of marks that are entitled to protection. You saw this concept alluded to in Peter's presentation: it is the inherently distinctive mark that is going to get the highest degree of protection, and it is also the mark as to which you will have the best chance of succeeding in a domain name proceeding. A mark with no distinctiveness is frankly not a trademark. If you want to call your bank "Bank," you can do that, but you are not going to get any trademark protection for the name "Bank."

I will briefly illustrate what some of the differences are. Inherently distinctive or fanciful marks are going to get a high degree of protection. To the extent someone registers "Kodak.com," there is going to be a strong presumption that the registrant did not do that in good faith. "Kodak" is an example of an inherently distinctive mark.

Now, the non-inherently distinctive remarks—what are also sometimes called suggestive marks—can result in more of a battle ground in terms of whether someone could have had an independently good reason for registering these marks. An example of a non-inherently distinctive mark is "Mop & Glo," which is what a floor polisher does. With a non-inherently distinctive mark, it is important to establish what trademark lawyers call "secondary meaning," which basically just means that when the consuming community sees this mark, it understands that it is a trademark and not a description of the product or what the product does.

This is also a problem that comes up with geographic marks. You could have a very difficult time in prevailing in a domain name proceeding with a geographic mark because there is a good likelihood that someone else might have a legitimate reason for using a name like "California." You may be able to establish secondary meaning for a clothing brand, but there are many reasons why someone might register "California.com" in good faith.

Personal names are another area. Even McDonald's, obviously one of the most famous brands in the world, started out not inherently distinctive. It acquired secondary meaning through its fame. And there are plenty of people out there named McDonald who might have very legitimate reasons for setting up "McDonald.biz" or "McDonald.org." Or, they may not. That is where the interesting work for us lawyers begins.

In terms of the elements of the trademark, one of the things I would like to discuss is the choice between using UDRP and going into federal court. A "sub"-choice is also involved here: If you're going into federal court, under what statute will you do that? You could bring a traditional trademark claim. You could also bring a claim under the federal Anticybersquatting Consumer Protection Act (ACPA). Frankly you would probably bring a claim under both. But there are differences between them that are worth spending time focusing on. The gravamen of a trademark complaint, the thing you want to really focus on, is the likelihood of consumer confusion. This is what I find fascinating about trademark law. Because with every other type of property that I am aware of, it is something that you can build a boundary around. This is the case even with a patent. In fact, that is what patent lawyers spend all their time doing: defining the claims, defining the boundaries of what the patent holder owns. You can write it down somewhere. With trademark rights, it is different. Trademark rights are out there in the minds of the consumers. And ultimately you may call yourself the trademark owner, but you are hostage to the perceptions of the consumers. Thus, the extent of your protection is going to depend on whether consumers are confused as to whether a mark adopted by someone else really indicates sponsorship or ownership or that you are somehow involved with this brand.

Under the ACPA, you are basically looking at a bad-faith attempt to profit from the registration or use of a domain name. That is where the focus is: Why was the domain name registered? How was it used? Was there bad-faith intent? In some ways, and we will focus more on this below, it can be easier or harder than a trademark case, depending on your facts.

Now let us turn to comparing a claim brought under the ACPA compared with one brought in arbitration under the UDRP. The obvious difference is the forum, whether you are going to be in federal court, with all that entails, as opposed to this expedited arbitration proceeding which Peter has described above.

To obtain personal jurisdiction over a defendant under the ACPA, one must satisfy the minimum contacts requirements of *International Shoe*. You will need to show minimum contacts in the U.S. in order to obtain personal jurisdiction over an individual or entity under the ACPA. The ACPA also provides for in rem jurisdiction that allows you to bring an action against the domain name if the domain name registrar or authority that issued the domain name registration is located in the United States.

Obviously, the UDRP is an international procedure. You can solve your problem anywhere in the world regardless of where the person who registered the domain name is located.

In terms of remedies, the ACPA gives you the benefit of statutory damages, which is a very useful tool in negotiation because judges have been awarding these damages. It is very difficult to show how someone's bad faith adoption and use of a domain name has harmed you, so the ability to invoke these statutory damages is a very useful tool. To the extent you can show actual damages, you may also obtain injunctive relief. This is in stark contrast to the UDRP. As Peter mentioned this point, but I really want to emphasize it: no damages are available under the UDRP. So all you are doing there is getting your domain name back; taking it out of the hands of the person who is misusing it. That may make federal court look like the better option until you look at some of these other factors, like speed. Peter discussed the timetables under the UDRP. I can tell you that they are rigidly enforced. You are going to get results for your client, and they are likely to be favorable. The statistics are that the claimant wins the vast majority of these UDRP cases. You will get your result within sixty to ninety days; that is, you will get your domain name back within that time frame.

The ACPA means federal litigation. You may be able to run into court and obtain a preliminary injunction and resolve the case quickly. But you may perhaps find yourself in protracted federal court litigation, which we all know can go on for several years, depending upon the district.

With respect to the cost issue, here the balance weighs heavily in favor of UDRP. Many firms, mine included, will quote a fixed fee for these arbitrations. If you do a lot of them, they are fairly routine. I suggest you follow Peter's advice and do not submit large amounts of paper but give the arbitrators what they really need, what they really want, because they are working on a fixed fee too, from between $3,500 and $5,000, with the main factor being whether you opt for one or three arbitrators. Again, I strongly endorse Peter's view that a one-person panel is the desired way to go. Unless you are the respondent hoping to muck things up or something like that.

Federal court litigation entails the cost of admission, going and getting a preliminary injunction, that is, actually obtaining it. In some parts of the country it may be possible to obtain the injunction for less than $50,000, but it costs money; you pay to play in federal court. These domain name litigations, if they are in federal court, also involve trademark issues. The statistics on trademark litigation nationwide indicate that a case that goes to trial tends to cost about a million dollars, as an average of the costs in all jurisdictions.

I would like now to focus on the elements required under the ACPA and the UDRP because this is a reason why you might be pushed into federal court. Under the ACPA, you're looking for bad faith either in the registration or use, whereas the UDRP requires bad faith in regard to both registration and use. This means that, if someone had a good-faith intention initially and later got greedy, you may have a problem proving your claim under the UDRP. As a matter of fact, you probably would not be able to prove your claim.

For an example, let me relate a common scenario that comes up all the time. A company is an authorized distributor, licensee, or retailer of a certain product and registers the domain name for that reason. The company had a good faith reason at the time of the registration. The relationship terminates, there are bad feelings, and the company decides not to give you back your domain name unless you pay for it. This is a classic example of cybersquatting but it does not give rise to a claim under the UDRP because there was no bad faith at the time of the initial registration.

There is another point to consider in choosing your forum: the consequences of a failure to respond. If there is no response in federal court, you get a default judgment. If there is no response in a UDRP proceeding, the arbitrator must still go through the motions of issuing an award, and you could actually lose. Now, obviously you cannot not win a case with no opponent—I wouldn't want to hire that lawyer—but it is just something to keep in mind: there is no default judgment in a UDRP proceeding.

MS. ENIX-ROSS: It has happened!

MR. FERGUSON: Another point to consider is the finality of the award. Although technically UDRP is going to be quicker, the problem is that you can go through the whole sixty to ninety-day proceeding and then the person can just push the case into federal court anyway. So if you know you are dealing with a bad guy, if you know there is a lot of bad blood, you may be just wasting sixty-to-ninety days and $5,000 to $6,000 with the UDRP. And that is when you should go into federal court.

Thank you. I appreciated your attentiveness, and I look forward to any questions that you may have.

MS. ENIX-ROSS: As you noticed, I was a bit strict about the time, because I wanted you to have the opportunity to ask questions and to really debate even these procedures. Yes.

AUDIENCE MEMBER: I'm concerned about organizations which have a legitimate interest in disrupting a business, say, for a boycott. It seems the UDRP says that, if you are trying to disrupt someone's business, well, you just cannot do that. You cannot have the domain name. But if you needed that to disseminate the information, you would need a similar domain name. How would you address that?

MR. MICHAELSON: You have to show bad-faith use. You are looking at the area that involves a person's right to criticize. What really decides the case is whether it is for a commercial purpose. As long as you are doing it

personally, that is fine. You can use the name. That is why you see these pejorative cases all the time. The domain names are not often transferred for that reason. But on the flip side, if you are doing it for commercial gain, for example, for extortion, that is a horse of a different color. So each case is very factually dependent.

MS. ENIX-ROSS: And let me say, at the beginning of the procedure when the Center was presented with the first of the pejorative cases, it was actually very interesting being on the inside. This was so because, first of all, this is a procedure that is used around the world. So the lawyers that present cases come from all kinds of jurisdictions: common law and civil law. And the panelists—we are very careful not to call them arbitrators, because the WIPO Center does have a whole arbitration procedure and this is really more like an administrative procedure—also come from both civil and common law jurisdictions.

Now, the ICANN rules do not give any kind of examples of what constitutes bad faith. The rules are otherwise very straightforward, just as we have laid them out. It became then a matter for each panelist to determine what bad faith meant. Interestingly enough, the common law notion of following precedent has taken hold, even though that is not a civil law tradition. But you will find, and I think now it is very well established, in most of these cases that there are certain agreements about what is bad faith. But the pejorative cases are still instances where there is a split. Because there are some people from some jurisdictions who say that you certainly have the right to criticize but you do not have the right to use my trademark to do it.

And there are others, mostly from common law jurisdictions (and it is actually mostly the U.S. panelists), who, as Peter said, feel that there is a constitutional right (under the First Amendment in the U.S., for example) to do it. This is very interesting. If you have a pejorative or criticism case, you have to think hard about whether or not you want to use these procedures because you do not know who the panelist will be. If you have a one-person panel, the center chooses the panelist. If you have a three-member panel, then the center tries to appoint one panelist from the list of candidates provided by each of the complainant and the respondent, with the third panelist chosen by the center.

So pejorative or criticism cases may not be the ones that you want to bring, especially if you know that it is an active Web site. I think that is what Gerry was alluding to. This procedure is not for everybody. It is really meant to be very straightforward, and that is why in 80% of the cases the claimants win because they can show all three elements very clearly.

MR. FERGUSON: I would like to add a quick follow-up. I certainly would advise a client who is organizing a boycott site to stay away from the UDRP procedure. I think it is too much of a wild card. But the reality is that, because you can go to federal court and get a de novo review, in which the court will give no weight to the UDRP, there is really no unfairness here. And, furthermore, the federal courts in the trademark context have absolutely recognized the First Amendment rights of these commentary and consumer-rights sites.

MR. MICHAELSON: If I may add a comment. We have been talking about de novo review in federal courts, but less than one-tenth of UDRP decisions are reviewed in federal court. And the reason, as Gerry points out, is the cost.

AUDIENCE MEMBER: Jim Duffy, past chair of the Section. I think it is worth mentioning that, although probably most of the domain names that figure into the UDRP will probably wind up in court because the registrar is located in the United States, it is not true in every case.

We have a client for which we established a company in Monaco with a very large portfolio of "Who's Who" domain names. "Who's Who" is a generic name. There are some "Who's Who" trademarks in the United States, but usually you have to disclaim any right or interest in the phrase "Who's Who." One of the related domain names is, of course, "whoswho.com." It is registered with Network Solutions, which means that it would wind up in a U.S. court. But "whoswho.fr" would not wind up in a U.S. court. In fact, we do have considerable trademark protection, but we obtained it through some European filings; by the way, we have them trademarked in China, which I think is a very interesting development. And we have faced challenges from the French Who's Who and also from Blackstones, the UK's Who's Who. But many of these do not implicate U.S. law. I think it is worth mentioning this since we are the International Law and Practice Section, there is also something that goes on outside the United States and does not necessarily ever touch the United States.

MR. FERGUSON: We are focusing on the U.S. I wanted to give an example of the international and national system. The U.S. is the obvious example because we are here, but your point is absolutely well taken. To the extent I have been saying that one will wind up in federal court, it could be a court anywhere in the world. You are absolutely right.

MS. ENIX-ROSS: Again, we are talking about the UN and a useful international system. The fact that the respondents may be located throughout the world so that it may be very difficult to get jurisdiction over them was an impetus for establishing this procedure. Here you have a procedure that enables you to file a complaint from your office, wherever you are in the world. With WIPO you can file it in any language that you choose. The choice

often depends on where the registrars are and what the language of the contract is. The panels are capable of handling and in fact have published decisions in any language imaginable, and the panel can handle procedures in those languages. It really is an international procedure although the bulk of the domain name registration cases have fewer parties because the U.S. has a significant number of trademarks and also a significant amount of respondents.

AUDIENCE MEMBER: One of my neighbors in Westchester County, Martha Stewart, was attempting to trademark a community, Katonah, for her line of furniture and so forth. So I guess it is a non-inherently distinctive geographic mark. Where do you think she is going to have a better chance of winning, number one? And if she would have chosen the federal penitentiary she was in, where would that fall in terms of the category? That is just a fun question.

MR. MICHAELSON: Let me see if I can answer the geographical aspect of your question. I have had a number of cases where respondents have argued that the mark which is registered by the U.S. Patent and Trademark Office (PTO) is really that of a territory somewhere or of a place, and that I, as a UDRP panelist, should bounce it out. Well, we take trademark registrations as we find them, and we do not have the power to alter them. What I tell registrars in my decisions is that, if you are raising a question in limine, you need to go to federal court or go back and file a cancellation action with the PTO. As far as I am concerned it is a registered trademark, and I will defer to the PTO, and that is it. So, if Martha is fortunate enough to get an examiner who is inattentive enough to allow the term "Katonah" to be registered, I am not going to know anything about it or invalidate it. I do not have the power to do that. That is where going into federal court makes more sense.

AUDIENCE MEMBER: You mentioned state court. My question is, if it is a common law mark or a state trademark registration, will state court figure into those situations that you just discussed?

MR. FERGUSON: Excellent question, since we are the New York State Bar Association. It is certainly an option. But if there is any use in interstate commerce of the common law mark or state trademark registration, you are going to find the case removed to federal court. But if you are in a unique situation where you have got a mark that is purely local in use and a state registration, your claim would simply be under state unfair competition and trademark law, which is a species of unfair competition law in New York. There is no state anticybersquatting statute in New York.

AUDIENCE MEMBER: The question relates to whether there has been any case where the registrar has not accepted a UDRP decision. For instance, the Colombian registrar might not agree to take the name out of its system, and then the complainant will have to resue in that country against the registrar.

MR. FERGUSON: The UDRP is really part of a broader contractual context under ICANN where the registrars themselves are contractually bound by rules of ICANN to follow UDRP decisions. Between you and me, domain name registration is enormously profitable. Registrars are not likely to want to lose their accreditation with ICANN.

There have been problems in the past with registrars moving slowly to transfer the domain names. Yes, there are problems, but I have not heard of instances where registrars have just flat-out refused. Perhaps Deborah being on the inside of WIPO has greater experience. Let me ask her view.

MS. ENIX-ROSS: I think that is right, Peter. If you are talking about commercial space (i.e., .com, .net, and .org), originally those registrars did agree under the ICANN rules that they would abide by the decisions if they come from an accredited center, and there are four accredited centers. It is a circle, and that is why it is effective.

There are, however, country-level domain names, and they can have their own procedures. Some countries are very strict and will only allow people to register domain names who are domiciled in that country; some are very open.

WIPO has worked with and has instituted similar procedures for countries. So there may be some countries that have not implemented this kind of procedure, and there you might have a problem. But registrars for what are called the .com, .net, and .org must comply.

AUDIENCE MEMBER: Would it be possible to apply simultaneously to WIPO and the national court if you wanted to have the domain name transferred quickly and damages?

MS. ENIX-ROSS: There is nothing within the UDRP or the WIPO procedures that would prevent you from doing that. I am not sure strategically why you would do it. I understand the notion that it is faster on the one side and that you may be getting monetary damages on the other side.

MR. FERGUSON: What I would be concerned about is this. If you win your UDRP arbitration, the registrar is then informed about this. The other side has ten days to object. They are going to say that, since they are in federal court, they are going to make counterclaims, so you have not accomplished anything with your UDRP. I think that, once you are in federal court, it is very unlikely that you are going to get a UDRP decision recognized.

MR. MICHAELSON: Often in these cases, damages are very speculative at best. It is tough to prove a mon-

etary injury. And many trademark cases do not result in stopping the use of the mark. So in your situation, of course you can proceed simultaneously since nothing precludes you from doing that. If your end goal is to get the domain name, to me it makes sense to go the UDRP route and see what happens, because there is a very high success rate through the UDRP.

MS. ENIX-ROSS: We have talked about the high success rate, and it is true that in 80% of the cases the claimants prevail. And that means that, in 20% of the cases, they do not. There can even be a default by the respondent where you lose; the reason that happens is that you have to prove all three elements of the case. If you do not prove any one of those elements, the complaint fails.

We talked about the history of this procedure, and it was really meant to go after a specific type of claim. So again, when you are evaluating this, look at back decisions. And the WIPO decisions now are all published, and there is even an index. So if you really want to know what bad faith is you can find the necessary examples of bad faith and determine whether or not your case falls within them.

One of my favorites is the penguin.com case. The book publisher said that it wanted the name, and there was an individual using the Web site, and he had published pictures of his family and kids and stuff, and his nickname was "penguin." Everybody apparently since he was a kid called him The Penguin, and he had pictures. But he was just kind of quirky, and he was able to keep that domain name. I think that was a decision that gave some credibility early on to the center and to the process. Because you cannot assume that it is always going to be a slam dunk, you really have to take every element of the case seriously, and you have to prove your case.

MR. MICHAELSON: Because of the intricacies sometimes in proving bad faith and the other elements, if you have a case for the first time, find counsel who have done it before. Ask to see what their filings look like because basically you have one shot to get it right. So preparation is important, let me not understate that.

MS. ENIX-ROSS: But as Peter said, all of the information, the complaint, the response, guidelines, all of that, can be found on the WIPO Web site. There is a digest; you can look at all the decisions. If you really want to read a thousand decisions, you can, or if you want to get to particular elements, it is all there. It is really good because it is transparent: decisions are published.

Peter mentioned that the fees that the panelists receive are really not commensurate with the work that they do. Let me say this as someone who has appointed panelists for four years: they were very dedicated. I think this is in part attributable to the fact that people know that their work will be published and will be there for the world to see. So there is a great deal of care used in writing these decisions. It was very interesting to see the common law and the civil law panelists coming together to form a consensus on some of these elements and to see that precedent has been followed in a procedure where really it does not have to be. Each panelist can come along and create and recreate. And that they do not, I think, is a real tribute to the procedure and the lawyers and the people who have been involved in this procedure.

Let me now thank the panelists for their presentations and the International Law and Practice Section of the New York State Bar for inviting all of us to participate in this panel. It has been very interesting and informative for us, and we hope so for you as well. Thank you.

III. UNCITRAL: Issues and Impact of Cross-Border Insolvency

A. Introduction

MR. HAMILTON: We have a panel of three. We have Paul Silverman, who is a partner with Alston & Bird here in New York and practices in the area of bankruptcy. Paul has a long history of wonderful work that he has done in this area. To his left we have Kurt Mayr, who is with Bingham McCutchen, in Hartford. Kurt is going to talk to us about forum shopping in cross-border insolvency. Last, but certainly not least, we have Lewis Kruger with Stroock, Stroock & Lavan, and he is going to talk to us about the treatment that multinationals get under insolvency proceedings. So without further ado, I'll turn the microphone over to Paul Silverman.

MR. SILVERMAN: Thank you very much for inviting me today. I understand that, because of the size of this panel, although the program says eleven minutes, we might expand it to even thirteen minutes. This is normally a one-and-a-half hour lecture so we are going to move at a speed that you are going to be satisfied with.

I am starting with the premise that many people here have a passing familiarity with bankruptcy law, but may not know that there's a "t" in bankruptcy. So we are going to move through it fast, and we are going to do it in a very general fashion. And then we are going to cover the cross-border issue, which is of primary interest of course to this section.

I will not get into the genesis of the U.S. Bankruptcy Code, the U.S. Constitution. The fact that you cannot bring this in state court; it can only be in federal court, and the fact that the primary purpose is to consolidate and to make efficient administration of situations where there is a conflict between the debtor and its creditors that cannot be resolved on a one-to-one basis. There is no need to go through that, because I know you know that.

So how do you commence a case? Well, generally, you need three or more creditors with a reduced amount of debt that is liquidated, not contested, not by an insider.

It could be $15,000; in this day and age it is generally doable.

How many people file involuntary Chapter 7s? Very few. Why? Because each individual creditor thinks best as to its counsel, and believes that, through its own counsel, it can realize more on its individual debt than to share with all the creditors and would rather not leave it to a trustee who does not know that one creditor and who has no fealty towards that creditor. So there are not that many involuntaries. There are voluntary Chapter 7s, for obvious reasons.

With Chapter 11, it is obviously clear that the United States has the best pedigree in regard to this type of reorganization. This approach started in 1938 as a result of the Great Depression's effect on the debt structure of landlords and banks that held interests in real property. They recognized that it is better to keep the debtor alive and paying like the golden goose, rather than killing it and having just one dinner. So they came up with a section in the law, which later became a whole chapter, which is Chapter 11, which you know through the various cycles has profited some creditors, some institutions and many counsel; not that that is its main purpose, of course.

The way in which a voluntary bankruptcy can be filed is very simple. The debtor will just identify that it has insufficient funds to pay its debts as they mature. It does not have to be, as in Europe, literally insolvent to start it. As some of you know, in one or two countries—in Germany, for example—they have just adopted a law within the last three or four years, where you do not literally have to be insolvent to open a proceeding, but you can file something in the nature of anticipation that you will become insolvent unless you have the protection of the court.

In the United States of America under Section 541, the property of the estate is not limited necessarily to the United States, because the statutes refers to all property of the debtor. It does not limit it territorially. One thing to remember though, when you get an order of the United States and it does not involve property or a person located within the enforcement jurisdiction of the United States courts, you then have to get the acceptance of a foreign court to enforce that judgment. So tax Americana only goes so far, ladies and gentlemen.

Section 365 of the Bankruptcy Code is a very interesting section that you should know about. It deals with executory contracts. What are executory contracts? Executory contracts are basically contracts in being as to which there is something more to be done than the exchange of money. For example, the repayment of a loan would not be an executory contract, but in a publishing case, where there are rights to enforce licenses, it may be an executory contract. Although one party may think it got all the money it was supposed to get and did not have to do anything else or gave all the money it was supposed to give and did not have to do anything else, there may be ongoing license requirements in the contract that make it executory.

So what? Well, an executory contract is in being continuously under Chapter 11. That is what we are talking about today, Chapter 11. An executory contract continues in being, notwithstanding the fact that the contract itself may say—you see clauses dealing with terms of default in real property agreements—that it is void if you file in bankruptcy unless cured within 60 days. As they say in Brooklyn—and I am not from Brooklyn—forgeddaboutit. It is not enforceable, has not been enforceable, but it is always included in the clause, and the response from the real property lawyers always was: well, some day the bankruptcy laws may change.

So an executory contract will continue, and your client will say, especially if it is a supplier: "I am not supplying it to that dead hole; it is not paying me back." You have a problem; you have to get the contract rejected. You have to make a motion before the court for the court to allow the contract to be rejected. And it is the debtor's interest that the judge is thinking about. Obviously, if the person does not have the wherewithal to pay for the ongoing supply of goods, it is likely that the motion will succeed. The questions get a little more sophisticated, however, and for that we will speak to a bankruptcy lawyer.

The automatic stay is another important feature critical to the concept of a Bankruptcy Court's administration of any case. Remember the concept of centralization, and in order to get centralization you have to get a stay of all other proceedings. Literally, under 362, whether or not the creditor has knowledge of the case, there is an automatic stay against any action against the assets of the debtor or the debtor itself, be it a company or an individual.

The effect of this is that you have to go into the court in which the bankruptcy case is commenced, and there is only one case and one court for each debtor. It cannot be several courts. If you have courts of enforcement somewhere else or litigation pending, you either have to move to move it to the Bankruptcy Court to continue, or you ask for it to continue outside of the Bankruptcy Court for some special reason. Alternatively, the judge merely says that all you have to do is file a proof of claim. And to the extent that the claim is not disputed, it is allowed in the amount you filed it. But it will be disputed, ladies and gentlemen, and the issue will then be in the context of a bankruptcy case adversary proceeding.

Duties of the debtor do not include just filing a petition although, in the beginning, the speed in which it occurred makes you think that. The debtor then later has to be available for examinations. That is not true in all other countries; it is true in the United States. And the debtor

has to make full disclosure. Sometimes such full disclosure issues run afoul of the debtor's Fifth Amendment rights; this involves corporations, and we see that more notably in connection with Sarbanes-Oxley. If the debtor is a corporation, the individual rights involved are those of the person who may be an officer who may be better advised individually not to disclose on behalf of the corporation, because it will be coming from his lips, and he may be making a concession he would not have otherwise made. These are dilemmas which people face. They need a lawyer to address them.

The role of the U.S. Trustee is that of an ombudsman. I think of it in terms of a floating cursor on a computer. That is to say, the U.S. Trustee does not represent any one person, but it has an opportunity to stand as a party in interest in any case and take a position. It does this for the greater good of the administration of the courts. This generally applies, therefore, in smaller cases where there are not sophisticated counsel to take care of the debtor's own interests and the interests of their creditors.

The U.S. Trustee will step in regarding fee applications where everybody seems to agree with everybody else's fee or where an examiner is needed because there's a sense that there is a misdeed in the ongoing operations, but where again no one for whatever reason is going to raise that issue. The U.S. trustee will raise it. And then there are Washington policies, which the U.S. Trustee is enforcing, and they vary every four years.

A sale of assets under Section 363 is very important to understand. You must appreciate that, while the chairman of the board of the corporation for which you have been hired thinks he is the prince of the city, he actually now steps down to duke it out. The bankruptcy judge now becomes the prince of the city. Anything outside the ordinary course of business—a sale of assets or taking on a whole new liability, for example—will require the approval of the court. There is full disclosure, together with notice, a hearing and a right for all parties to be heard as part of the court's manner of proceeding. And then there is an eventual decision by the court, which of course can be appealed.

That style that I just described to you: the openness, the right to a full hearing, the judge's control of the case, the judge's playing chairman of the board, that is all unique to the United States when you compare it to Spain, to Germany, to England, to France, where much of the case is controlled through what is called in the different languages the foreign representative or, more specifically, the receiver. That is not an absolute. The control ultimately is with the judge, but by and large it is not anywhere near the control that is exercised in the United States, and there is not anywhere near the openness you have in the United States. And for a number of I think not just cultural but engineering reasons, you do not have the accessibility we have through the service called "Public Access to Court Electronic Records (PACER)," with which many of you may be familiar. You can be in New York and electronically find every filing of a bankruptcy case filing in California. You cannot do that in other countries. This changes the dynamics because, as somebody once said, information is power when used correctly.

Let us now turn to equitable subordination. Many times, equitable subordination issues arise in the context of stock: the person got stock for value and now wants to use the stock as if it were a creditor for dollar value. And the person will be subordinated, because the stock is by its very nature less than a creditor position in an absolute dissolution. There will be issues of equitable subordination when the insider, for example, says that he or she made those loans, and it is then quickly pointed out to the insider that, while that may be true, he or she never had sufficient capital in there to run the intended business.

This issue is not uncommon to a European foreign agent or a foreign corporation that has a unique product and only wants a distributor corporation in the United States. It sets up a separate distributor corporation and says that it is a long arm and has nothing to do with the foreign corporation. I suspect that they do this at the time primarily for tax reasons. In the end, when it all spirals downward—and, in my end of the business relationship, things only spiral downward: they do not tend to spiral up although they do get reborn—what you have is equitable subordination and a lower position than that of a regular creditor.

These are the research tools: the PACER service I referred to, Westlaw, LexisNexis, various journals, and, I might point out, the New York State Bar Association's Web site.

Now I would like to talk briefly about the UNCITRAL Model Law on Cross-Border Insolvency.

The UNCITRAL Model Law was adopted by the United States in October of 2005. It is not too dissimilar from Section 304 in concept, but the formalities make it more efficient than the way things were previously done under Section 304. Section 304 was almost a one-sentence section in the old Code, the 1980 Bankruptcy Code. And under the amendments to that Code we now have a whole chapter making it more formalized, more understandable, taking a lot of discretion away from the judge.

What does it do? It codifies comity. It respects foreign laws. It provides for court-to-court communications where the judge in England can call the judge in America and have conversations, not ex parte, not without prior notice. It is done for defensive and offensive purposes. It is time-efficient. If a foreign representative seeks access or the debtor seeks assistance from the court, you see the reasons. It is not just a foreign representative that avails itself of this: the debtor in the United States might seek

assistance from the foreign court, dealing perhaps with a foreign case pending concurrently. Maybe a foreign interested party is commencing a case: foreign creditors can commence a case in the United States.

What are the questions you need to ask? If the foreign, i.e., non-U.S., case is administered in the location of the "registered office" of the debtor, which is the presumed "center of main interests," then the case is a foreign main proceeding. Then you get an automatic stay. You get that automatic stay, twenty days. What if it is not? What if the non-U.S. case is administered in the location where the debtor has an "establishment," which is where the debtor carries on "nontransitory economic activity," then the case is a foreign nonmain proceeding. Now it is at the discretion of the court to grant an automatic stay. If it is neither a main nor a nonmain proceeding, then there is no recognition, no relief. You have to have some basis for the foreign representative's doing something on behalf of the court from which he got the authority. It cannot be just an off-shore shell. It cannot be manifestly contrary to the policies of the United States. We do not have too many cases on that. You have to draw your own conclusions. Much of the meaning of the chapter, as it is new, is going to be made clearer by court decisions.

When I say access, I mean that you can put a foreign trustee into the United States: that person can do all his or her enforcement—collections and defensive work—through one court. The evidence that person has to submit is very small. He or she just has to prove that there is a foreign proceeding and that he or she is the appointed representative, and then he or she has to make a statement of all pending foreign proceedings and must ask for either main or nonmain status. He or she has to give a list of creditors. The foreign trustee can get provisional relief, and I have done this in fact recently: twenty days for the notice of hearing, to give me the final relief I needed within those twenty days for emergency reasons. I got that emergency relief within three days, and that carried me for the twenty days.

You can act, in other words, you morph in, as a foreign representative: you morph into the United States as if you were a U.S. Trustee. You can also file a Chapter 11 proceeding through the distribution corporations in the United States.

I want to thank you for your patience. I do not know whether there is any time for questions, so we will take them at the end. Thank you.

B. United States as the Forum of Choice

MR. KURT MAYR: Good morning. I would like to preface my comments today by noting that Anthony Smits was originally slated to provide the presentation today. He was an attorney at Bingham McCutchen. He was suddenly struck down with cancer earlier this year at the age of 38. I am here as a last-minute substitute for him, and my comments and presentation today are in his memory.

As with Paul's presentation, this is a significant piece to get your arms around in so short a time. What I would like to do is focus on some case studies with respect to the way in which the U.S. Bankruptcy Code has been used in a number of recent cases as a forum of choice for debtors and, in some circumstances, creditors.

We have all seen a rise in the scope of multinational corporations. As we bankruptcy lawyers like to think, every boom is followed by a robust bust. When that bust occurs and you have a multinational entity with assets and operations incorporating different jurisdictions throughout the world, a very complex situation results in terms of determining what is the appropriate jurisdiction and what is the appropriate law for resolving insolvency issues presented by the financial crisis.

In the case of a multinational entity, you end up with sort of a classic forum-shopping situation, where the debtor and management, whose number one job always is to keep management employed, look for a jurisdiction which has the most debtor-friendly laws. In many circumstances they turn to the United States and Chapter 11, which is used by many people as the most debtor-friendly insolvency law in the world. On the other hand, creditors want a regime where they are going to be able to access assets and get recoveries as quickly as possible. They might not want management to keep their jobs. What ultimately results may be a race to the court house, the very thing that the insolvency laws are designed to avoid.

Historically, when the multinational enterprise was predominantly located in common-law countries, there were some flexible common law principles and statutory regimes that could be invoked to try to sew together an insolvency process that was occurring in multiple jurisdictions. The principles of comity, which are well known in common law jurisdictions, and in the United States, as Paul mentioned, we have Section 304 of the Bankruptcy Code, now Chapter 15, which codifies principles of comity. If, on the other hand there were significant numbers of jurisdictions involved in a multinational insolvency, the process could grind to a stalemate because many of the statutory regimes in the civil law countries did not include mechanics like Section 304 or Chapter 15.

What I would like to do now is really focus on Chapter 11 and how it has been used by foreign debtors and their creditors in some quite significant recent forum shopping cases. Access to jurisdiction Chapter 11 of the United States Bankruptcy Code is very broad. Section 109 of the Bankruptcy Code essentially says that if you have a peppercorn of property in the United States or any place of business, and that place of business is not deemed to be your primary offices or really any place where you

conduct substantial business, you can be a debtor under Chapter 11. And the breadth of that access to Chapter 11 and all of the rights that are associated with the automatic stay, the ability to reject contracts, the ability to obtain post-petition financing, and for management the ability to stay in control of the company and not be replaced by a trustee are all things that are very attractive and very easily accessible.

That breadth of access is tempered largely by judicial discretion under the dismissal and abstention provisions of the Section 304(11) and (12) of the U.S. Bankruptcy Code. As we walk through some of the cases, we will see how the courts have invoked these provisions.

A number of cases have involved really almost fully consensual Chapter 11 cases, where debtors have come to the United States to take advantage of some provision of the Bankruptcy Code, for example, the ability to bind all creditors to a restructuring and to use the rejection powers that Paul mentioned in his presentation.

A couple of recent examples of these were prepackaged cases. A prepackaged case is a case in which, before filing for bankruptcy, the debtor solicits and reaches an economic compromise that is acceptable to the creditors it intends to affect with the restructuring plan, and the debtor gathers sufficient votes and so forth before ever filing for bankruptcy. Then the debtor files for bankruptcy and says, "Hello, Judge, we are here. We've already done everything. We just need thirty days of your time. If you would then confirm our plan, we'll be out of your hair." The advantage to that process is that it is binding on all creditors. The Bankruptcy Code purports to be extraterritorial. And, if the creditor body that the debtor is seeking to affect is predominantly U.S.-based or has significant enough U.S. connections to be concerned about being subject to the jurisdiction of the United States Bankruptcy Court, that sort of a restructuring can be very useful and can provide a more efficient process than would otherwise be available under the domestic laws where the debtor actually has its predominant operations and assets.

But it is not always consensual, and there have been a number of cases in which debtors have sought to invoke U.S. bankruptcy jurisdiction under Chapter 11 to keep management in place and to try to move forward with restructuring upon management's terms. The *Cenargo* case is a good example of this. Cenargo was a UK incorporated entity. All of its assets were set forth in a bank account that was only opened in the United States shortly before the bankruptcy filing. They were outside the United States; all of its operations were outside of the United States. But management wanted to avoid a proceeding in which it could be removed by a trustee in an insolvency proceeding outside the United States and instead filed the proceeding here.

Creditors who wanted to oust management and were not happy with that result very quickly filed an administration proceeding in the UK and obtained an injunction against the debtor's continuing with its Chapter 11 proceeding in the United States. This resulted in a virtual stalemate of the restructuring, which was ultimately resolved by the U.S. Bankruptcy Court, using the principles of abstention and dismissal that I mentioned earlier, recognizing the reality that the gravity of interests of this entity was not in the United States. And, although there was a bank account in the United States so that there was a peppercorn of property to support jurisdiction, it simply did not make any sense as a matter of international comity to continue with the proceeding here in the face of a proceeding in the United Kingdom. Ultimately the Court abstained.

Perhaps the most blatant example of a forum shopping case involving the United States Bankruptcy Code was the filing by the Yukos oil company about two years ago. Yukos is a Russian oil company, a natural gas company, an energy company. Virtually all of its assets are located in Russia; there are no assets in the United States, other than a retainer account for its lawyers that was set up within one week of the bankruptcy filing.

Yukos was one of the major success stories of the privatization of the Russian economy, but ultimately it fell in disfavor with the Russian government. The Russian government claimed that the company had been involved in a $27 billion tax fraud, put the CEO in jail and proceeded to close on the company to collect the $27 billion in taxes. The company responded by opening up a bank account to retain its attorneys in Texas. It had one of the managers move to Texas with his laptop and claimed that Texas was now the principal office of the company, and they filed for Chapter 11 one week later. The reason they did that was to invoke the automatic stay, which purports to be extraterritorial. And in addition to that, they sought a temporary restraining order and told the world that the foreclosure could not go forward, and that, even if they could not enjoin the Russian government, any of the banks involved in the transaction and any other third parties who are involved who have any interest in the United States—and they all did—would be in violation and contempt of an order of the United States Bankruptcy Court.

This completely froze the process. The foreclosure and the sale could not go forward until the judge was presented with a motion to dismiss the case and a request to abstain, based upon the fact that, notwithstanding a bank account in the United States, which supports jurisdiction, it simply did not make any sense as a matter of international comity for the United States Bankruptcy Code to be invoked in this manner.

Debtors are not the only ones who seek U.S. jurisdiction in the insolvency context as a matter of forum shop-

ping. There actually are circumstances in which creditors think that the U.S. Bankruptcy Code is more advantageous than foreign insolvency regimes.

One case Paul and I actually were both involved in this context was the *Multicanal* case. Multicanal was an Argentine company that got involved in an Argentine financial crisis and was not able to meet its bond. It filed and commenced a proceeding in Argentina under a new bankruptcy law that is largely modeled after the United States' pre-packaged bankruptcy laws. They had solicited creditor support before commencing the proceeding and wanted to proceed with a very quick court process to confirm a restructuring plan. But one large creditor, who was less than one percentage point short of a locking position on that vote, did not like the economics of the plan and started to derail the process by filing an involuntary bankruptcy proceeding in the United States, claiming that U.S. bankruptcy law, not Argentine bankruptcy law, governed and that an Argentine company that had no assets or operations in the United States other than a bank account with $9500 in it ought to be reorganized under Chapter 11, not under Argentine law. And the court was faced again with the question of determining whether or not that made any practical sense as a matter of international comity. The court ultimately concluded that a company that was subject to a foreign proceeding that met the requirements of international comity ought to be able to go forward with its insolvency proceeding under its local law and should not be held up through an involuntary filing in the United States.

A similar situation can be found in the *Globopar* case, which was actually commenced by an affiliate of the very same creditor who commenced the *Multicanal* case. That creditor again was upset with the progress with the court's restructuring negotiations in Brazil relating to a Brazilian entity that had, I believe, no assets in the United States other than perhaps a bank account. The creditor was not happy with the manner in which the restructuring negotiations were proceeding and sought to use the U.S. bankruptcy filing to invoke the automatic stay and halt those proceedings.

Here, too, the court looked at the circumstances and the progress that was being made with the general creditor body and came to the conclusion that it ought to abstain. The case was appealed and has been reversed, but the appellate decision endorsed in theory the concept of abstention and just asked for more of a factual analysis to be performed by the bankruptcy court below.

I would like to turn briefly to Chapter 15, which you just heard about generally from Paul. I would just note that it is a new law and there are not too many cases. It largely remains to be tested. There are two cases worth noting for purposes of international forum shopping that have come out in the last couple of months.

As Paul mentioned, the essential issue to get maximum relief under Chapter 15 is whether or not the foreign proceeding—the proceeding to be recognized in the United States—is a main proceeding, a main insolvency proceeding, in which case the United States proceeding really ought to be an ancillary and supportive proceeding, and the U.S. court is mandated under Chapter 15 to cooperate and assist the foreign main proceeding through relief in the United States. Whether it is a main proceeding depends upon whether the debtor's center of main interests is in the foreign jurisdiction where the proceeding is taking place. The statute really just gives you a presumption that if the foreign proceeding is in a jurisdiction where the debtor is registered, the proceeding in that jurisdiction is presumed to be the foreign main proceeding, but that is a rebuttable presumption. The statute otherwise does not give any color on what center of main interests means.

In the recent case of *In re Sphinx,* which was a Chapter 15 proceeding, we were at least given some additional color by the Bankruptcy Court here in the Southern District of New York. In that case, that case was related to the *Revco* bankruptcy, which was proceeding here in the United States. Many of you may be familiar with the *Revco* case. In connection with the case, the Sphinx Funds, shortly before the bankruptcy, had received a $300 million transfer. In the *Revco* case the creditors and the estate sought to recover that $300 million in a preference avoidance action, which was ultimately subject to a settlement in the bankruptcy proceedings. Unfortunately, the creditors of the Sphinx Fund, which itself was facing insolvency, were not pleased with the economics of that settlement, and so they caused a Cayman insolvency proceeding to be commenced. They then came to the United States and sought Chapter 15 relief to enjoin the settlement in the *Revco* case.

The fund itself was incorporated in the Caymans and had no other connection to the Caymans. Every other connection that it had was to the United States. Its assets were here; its business was here; its offices were here. Nonetheless, they sought through the Chapter 15 case to argue that the Cayman proceeding was a main case, which would trigger the automatic stay and halt the bankruptcy process in the *Revco* case and halt settlement from going forward.

The judge, faced with determining whether or not the Caymans were really the center of main interests, ultimately concluded that on those facts, it could not possibly conclude that the Cayman proceeding was a main proceeding, and therefore the automatic stay did not apply. In doing that, the judge gave us a little more color on what the center of main interests would be considered to be. He adopted the definition under the EU regulation, and that definition really looks to where the debtor regularly administers its interests in the manner that is as-

certainable by third parties. This definition has been also adopted in the Ninth Circuit in a recent Chapter 15 case.

It is a new law. It remains to be tested, and it is an exciting opportunity for those of us in the cross-border insolvency area of practice. We will take questions at the end. Thank you.

C. Insolvency of Corporate Groups

MR. LEWIS KRUGER: We are now going to talk about something that is not the discussion of law, but in one sense more the discussion of lore since it is not clear yet whether the effort that UNCITRAL is now making with regard to the insolvency of corporate groups will lead to any result.

Let me begin at the beginning. I assume you all know UNCITRAL, the United Nations Commission on International Trade Law. Working Group V of UNCITRAL is the UNCITRAL Working Group that deals with insolvency. I serve as liaison to UNCITRAL Working Group V for the International Bar Association (IBA) through its Section on Insolvency, Reorganization and Creditors Rights. Working Group V is the one that has been wrestling over the last year or so over the question of whether or not there needs to be something done with respect to corporate groups as distinguished from the current state of insolvency laws in the various countries around the world. That subject has commenced really with a broad view back a year or so ago in Vienna, where there was a discussion about whether or not there was a need to do anything at all with respect to corporate groups. The question really is whether we do not already have enough in the way of insolvency laws in the various jurisdictions around the world that are perfectly comfortable in dealing with corporate groups in their own countries. The conclusion was basically that maybe there is a need to at least try to do something, because corporate groups have become more and more the way of the world, certainly since the 1920s and 30s. With the recent increase in globalization and the like, corporate groups are the principal structure for doing business everywhere in the world. The question is how you begin to deal with the insolvency of corporate groups.

First, you have to think whether there is really a need for doing anything. And what is a corporate group? Well, when you think about that, and we talked a little bit about the Bankruptcy Code. One of the things in the Bankruptcy Code is Section 1102, which says there should be a creditors committee for the debtor.

Well, you remember when Enron went into bankruptcy proceedings a few years ago, it had more than forty-five hundred direct and indirect subsidiaries. There was no law big enough in the country to deduce the actual corporate structure of Enron, and along the way, they filed perhaps two hundred to three hundred entities that ultimately went into the bankruptcy proceeding. During the course of the first several months, the lawyers seeking to have additional creditors committees formed for the various subsidiaries where they believed their creditor-clients' claims would be better treated than in some generalized way came into bankruptcy court and suggested that the Bankruptcy Code does say a separate creditors committee for the debtor. Of course, obviously one cannot have three hundred creditors committees: they would eat up the whole estate in lawyers' fees, which is probably not something the creditors would have found acceptable. The ultimate result was that there was, as part of the relevant proceeding, a committee consisting of creditors (i.e., the larger ones) of some but not all of the entities.

That brings us back to the observation that, at least in this country and in most of the countries of the world, we have a single-entity system. That is to say each separate corporation goes into the insolvency proceeding on its own. There is the underlying question of whether or not you need to be insolvent to enter an insolvency proceeding, and the answer to that question varies depending on where in the world you are. In the United States you need not be insolvent to take the benefit of an insolvency proceeding.

As we looked at these kinds of issues and thought about them, it occurred to us that there may be some version of the Hippocratic oath in order: if you are going to tinker with the law, make sure you do no harm in the first instance. So there is an argument to be made that, in a variety of different jurisdictions, different legal traditions have managed to deal with corporate groups. On the other hand, there is a high incidence of and increasing sophistication in corporate group structures. Intervention obviously has some risk because you may be disturbing commercial relationships that already exist, but that should not deter us from thinking about that and doing something about it.

As I said, in November of 2005, a meeting was held in Vienna by Working Group V for a discussion of this subject. That then resulted in a presentation by the Secretariat of UNCITRAL to the Working Group briefly at the United Nations in New York this past July. That then led to a five-day meeting in Vienna this past December.

With regard to the December meeting in Vienna, I would like to note that the International Bar Association is a non-governmental organization, so we are more or less in last place among the ones who contribute in terms of comment on the floor. On the floor governments obviously get to have the first shot. And there were probably some forty-odd governments present. So those of us from the NGOs or nongovernmental organizations, as we are called and who sort of cluster around the back, are the last to speak. On the other hand, we probably contribute a great deal of the work. So the work that is now being done on this question of corporate groups is being done primarily by the IBA, and, to some extent, by the

International Insolvency Institute, by InSolv and a few other organizations that are participating.

So what is meant by a "corporate group"? Essentially what we think about is a group of companies or corporations that are bound together either by a common business, by common ownership, or perhaps by common interests. There are a number of variations, of course, with respect to that. For example, must it be 51 percent common ownership that makes it a corporate group? Can it be something less than that? Is it interlocking obligations with similar lenders that make it a corporate group? There are a whole variety of things that you can think about as being the basis for a corporate group.

We then get into the second question: assuming there is a corporate group, and they are meant to file an insolvency proceeding, do you have what the United States has, which is a separate proceeding for each entity? That, as I said, is the rule in the majority of countries around the world, but not the exclusive rule by any means. There are a number of countries that have an enterprise rule, that is, when the parent or member of the group goes into an insolvency proceeding, the rest of the group is ipso facto included in the same insolvency proceeding. And it does not matter whether or not the entities that go in are solvent or insolvent. It is an enterprise rule that simply says that the parent and members of the group are essentially responsible for each other's obligations.

We sometimes get to that same conclusion in American law, but through a different mechanism. We even go through subsequent consolidation as a way to achieve that kind of result or there is a piercing of the corporate veil in some fashion to see if you can get access to assets of an entity that is not necessarily the direct entity to whom your creditor/client has extended credit. But that is a different method than simply providing that, from day one, the filing creates one proceeding for all of the members of the group.

Then the question arises as to who may commence that proceeding. Is it just the parent who can do that? Can any subsidiary do that and bring in the parent? What are the standards for bringing the parent in? In the United States a separate corporate resolution by the board of directors is required for each of the individual entity filings. As I noted above, there is something similar required in most, but by no means all, countries of the world. Is there a need to tinker with that system? And what by the way is the end result to be? Is the end result to be a proposed piece of legislation like Chapter 15 of the U.S. Bankruptcy Code or a similar provision in UK or EU law? Possibly not; maybe all that will be left at the end of the day after we go through this process is going to be a protocol regarding court-to-court communications.

I remember that, back in the 1960s and 1970s, the idea that a bankruptcy judge in New York would pick up the phone and call a judge handling the same type of bankruptcy proceeding of a related party in a corporate group in England, for example, was unheard of. No one would have thought about doing that. And yet it did indeed occur from time to time. And we had in effect a kind of informal arrangement with respect to the courts. As time went, on judges became more comfortable with the idea. If you look at *Maxwell* and other proceedings, courts began to talk to each other more regularly. And in fact, we are a step ahead of the process, if you will, because they recognized that they did not want to have duplicative proceedings. They had to decide where preference actions would be brought, where fraudulent transactions would be brought, where the various parts of the case were to be determined and dealt with. And it is very hard—when you think about this in the international context—for countries to give up some portion of their sovereignty over these kinds of issues.

Now let me come to what I think is the crux of all of this. There is no doubt that there are indeed corporate groups, and there is also no doubt that some of them get into insolvency proceedings, and that those insolvency proceedings will be located in many countries of the world.

When you think, just for example, of Ford Motor Company or General Motors, they have operations in virtually every country of the world. If either of them were to go into insolvency proceedings, how would you treat all of their subsidiaries in all of the rest of the world? Do they have some obligation to the main parent? Can their assets be used for the main parent? In the United States we would say that, to the extent they have value above their debts, that value is available to whoever the shareholder might be up the corporate ladder to the parent. That is not always the case in other parts of the world where a filing by the parent, as I said, would be a filing by the entire group.

The issue I deal with these days is post-filing financing. The model code on insolvency states, and it is obviously quite true, that companies that file proceedings may need post-petition financing in order to enhance the value of the estate. For example, in a Chapter 11 proceeding we have a provision called debtor-in-possession financing. We can accomplish this by getting some lender to lend money, and we give that loan priority over perhaps even existing secured debt and the like, but certainly over existing unsecured debt. In many countries this process does not exist although countries are beginning to recognize that, even if there were to be a liquidation proceeding, to get to the point of a liquidation you may need post-petition financing.

How do you deal with post-petition financing for corporate groups in international settings? Can you prime, for example, the existing debt of a solvent or insolvent entity in a different country than the country where the

main proceeding is taking place in order to secure financing for wherever the main proceeding is taking place? Those are the kinds of issues that are the grist for the mill in this kind of a process.

So what I would say to all of you is that I do not have, if you will, a conclusion to bring to you. I have a lot of very interesting questions to think about. And you may want to think about them as well. I suggest to you, if you have thoughts about them, send them along to me. I would be happy to see what other people might think in dealing with all of these issues.

The result of the process that is now ongoing will be a meeting in New York in May of UNCITRAL's Working Group V, which we will try to refine a little more to reflect what we really think the issue is, what we think the approach is and what we think the end result might be, as well as to try to think through debtor-in-possession financing on a global basis for corporate groups, because certainly that is where we are today in the world.

D. Automatic Stay as an International Tool

MR. SILVERMAN: Has anybody here been involved in representing someone in a cross-border dispute that involved the United States?

AUDIENCE MEMBER: Yes.

MR. SILVERMAN: It is a lawyer, and it is very unusual to have a good witness like that. Ask the question; gave the answer. Do you have another question?

AUDIENCE MEMBER: Have there been any cases that have dealt with the automatic stay being used as an international tool rather than as a domestic tool?

MR. SILVERMAN: Well, yes. I think Kurt mentioned *Multicanal*. And *Multicanal* was, as Kurt mentioned, an Argentinian Chapter 11 case. But to be more specific, in the Chapter 11 case, Multicanal was the second largest cable distributor in Argentina. So from the teenagers on down, everyone knew the name "Multicanal."

What occurred was they thought they had taken care of the change in the value of the dollar and what they distributed in Argentina. In other words, they used U.S. securities for their debt refinancing but, of course, the repayment of those bonds was stated in U.S. dollars. Unfortunately, there was a devaluation of the Argentinian currency, which made the ability to repay in U.S. dollars three times or more as onerous as what would have been required to pay in the Argentinian currency that had been devalued.

Therefore, when the Argentinian reorganization involved the bonds and did not deal with them in U.S. dollars, it appeared it was unfair discrimination to some bondholders in the United States. As a result, the bondholders in the United States brought an action in New York to enforce their rights under the U.S. securities laws. And here is where we get effectively to Chapter 15, which was Section 304 two, three years ago.

The law firm representing Multicanal filed a bankruptcy petition. The automatic stay immediately stopped the U.S. securities action. And then to make it more complicated, the bondholders filed their own Chapter 11 petition in an attempt to take control from Multicanal in the bankruptcy. There was a duel there between the bankruptcy lawyers. The question was: was the United States effectively the tail of the dog in the bankruptcy case going to take control of the whole plan of reorganization of an industry that was vital to Argentinians. And were the United States representatives of these bondholders—who might have effectively been what are referred to in a denigrating fashion as scoffers or people who recognize the risk and take advantage of the timing—left in the pot? And they really were not being harmed, at least to the extent that they lost their anticipated windfall profit. Those kind of arguments do not hold up in court, however.

So the tension remained, and finally through only a settlement at the end was that dispute resolved in the United States with respect to U.S. bondholders. And that then freed the Argentinian courts to go forward.

The dynamics between the courts was interesting because the Argentinian courts have certain rigid protocols which they were not about to bend to allow for the flexibility that is provided to U.S. bankruptcy judges. And the U.S. bankruptcy judge wanted to afford comity to Argentinian law but it would not allow for an unfair treatment of "his people," the U.S. citizens or holders that received their funds under the laws of the United States. There was a tension there but it was resolved.

MR. KRUGER: The automatic stay basically can only apply to those within the court's jurisdiction. So if the U.S. court believes it has worldwide jurisdiction and the entity against whom the automatic stay is entered is not in this country and does not file a proof of claim in the insolvency proceeding, it is hard to see how the U.S. Bankruptcy Court precludes a creditor in that country from seeking to enforce its rights against assets of the entity in that country.

MR. SILVERMAN: That is a good point. As a matter of fact, in *Multicanal* they did go to Argentina, and they did it in such a manner that an arrest warrant was issued. The way they went about it did not necessarily conform to the ways of handling things in Argentina. So yes, you can go to other countries, but be sure to have a return trip ticket.

MR. MAYR: I think another good example is the *Yukos* case that I mentioned, where literally the bankruptcy was just filed for the purpose of using Section 362 to halt the entire foreclosure process that was taking place in Russia. Everybody I think realistically recognized that

Section 362 was not going to apply to the Russian government. The foreclosure and sale were financed by local banks that had operations and interests in the United States. At the end of the day, they were unwilling to go forward with the foreclosure and sale because of their interests here: they did not want to be in contempt of court in the United States. Until the court dismissed the case, the automatic stay played a very significant role for an entity that had really no connection to the United States.

AUDIENCE MEMBER: I think this follows up on that point. Mr. Mayr, you mentioned the *Cenargo* case. As I understand it, in the *Cenargo* case the Chapter 11 proceedings in the United States were filed first. The automatic stay was in place and certain secured creditors commenced an action in London for an administration in any event. As best I have seen, not being a bankruptcy lawyer, those secured creditors who did appear in the Chapter 11 proceedings in the United States were never punished with contempt or any other penalty that the Bankruptcy Court might impose.

Those of us in the non-bankruptcy bar, when we are advising some of our foreign clients, particularly foreign lenders, are really pretty rigid about telling them not to break that automatic stay. Does *Cenargo* send some different signal?

MR. MAYR: In *Cenargo* there was a breach, a violation of the automatic stay, at the beginning, but that ultimately did not carry water with the court.

Obviously, the most prudent advice is to say that you would like to go into court to get relief from the automatic stay in order to take action outside the United States. But by doing that your client risks putting itself before the bankruptcy court in the U.S. and becoming subject to its jurisdiction.

I think there is a reluctance among bankruptcy judges to find the filing of an insolvency proceeding in the United States or outside the United States itself to be a violation of the automatic stay.

Multicanal again is a good example of that. In commencing its Section 304 action, Multicanal obtained an injunction that was similar to the automatic stay. It said basically nobody could do anything to affect the assets or operations of Multicanal anywhere, in any court, anywhere in the world. And the creditor responded by filing an involuntary proceeding in the United States. We brought a motion for contempt of that temporary restraining order against those creditors, and we lost because the judge felt that, at end of the day, exercising your right to file an involuntary proceeding, to invoke the insolvency laws, was not a breach of an order that was in sum and substance the automatic stay.

MR. SILVERMAN: I do want though the audience here to recognize you are putting yourself on the line when you tell somebody anything contrary to the fact that there is an automatic stay. It is a risk for the client, and I suggest that the client—not the attorney—should alone be the one who decides to take that risk. It may turn out right, but the attorney does not have to take part in that gamble.

MR. HAMILTON: Please join me in thanking the panel for a delightful presentation.

IV. Doha Round at World Trade Organization: World Trade in Crisis

A. Background

MR. HAMILTON: We are now in 2007 and threatened by the expiration of the fast-track authority that the President has. And indeed, that may well be the impetus that propels us towards reaching some sort of agreement so that we can complete these negotiations.

It might serve as some consolation to know that the prior two rounds, the Uruguay Round and the Tokyo Round, also faced what seemed at the time insurmountable barriers. Yet we were able to successfully complete them. The Uruguay Round, you might recall, needed a basic jolt that was provided by the U.S.'s initiative to initiate what we now know as "APEC," which is the Asian Pacific Economic Community. That served as an impetus for the Europeans to realize that they needed to get to the table if they did not want to be left out of some sort of a free-trade area that was being developed.

It may well be that that is what we have to do this time. I am not so sure that the threat of the President's expiration of his fast-track authority will do it. What do we have to provide that jolt? Well, we will deal with some of these issues.

We have with us Andrea Ewart, who is a sole practitioner and trade lawyer in Washington, D.C. She is going to talk to us about the WTO position with respect to these negotiations, and a lot of other competing interests with respect to the developing nations and their own interests.

We also have Charles E. ("Trip") Dorkey. Trip was the managing partner of Torys in New York City before joining McKenna Long & Aldridge in New York. I have asked Trip to talk to us about U.S. trade policy, with particular emphasis on the Doha negotiations. In addition, we have Andre Bywater, who likewise will speak regarding the European Union and the new member states to the European Union. And he will have a few comments regarding the rest of the European factors that may influence direction in this round. Last, but certainly not least, is Ricardo Ramirez, who is a partner with Thacher Proffitt in Mexico City. He has a long-standing career as a negotiator for the Mexican government with different types of trade arrangements and agreements, and he will answer

the question as to whether Latin America needs Doha. Without further ado, I'll turn it over to Andrea.

B. Status of the Doha Negotiations

MS. EWART: Thank you very much.

What I am actually going to do is give you an overview of the status quo in respect to the Doha negotiations and the WTO position per se. I will focus on the issues, a number of competing issues, particularly from the perspective of developing countries.

Let me start with a couple of anecdotes. For about a six-month period starting in October of 2005 through March 2006, I did some work and was part of an IDP-funded team working in Guyana in the continent of South America. It's a politically young country; it is a Caribbean state.

Our work was to come up with a strategy to promote export competitiveness, particularly small- to medium-sized businesses in Guyana. My specific focus was to assist in the development of a framework to assist Guyana to develop its trade policy and also its negotiating positions with respect to the various trade forums in which Guyana was negotiating, including the Doha Round. I raise this, because as I said, our work concluded in March 2006. The Doha Round was scheduled to be completed initially at that time in December of 2006.

Here is another anecdote. I remember talking with a couple of people who participated in a Caribbean delegation to the Hong Kong ministerial conference in December of 2005. They talked about for the first time being able to have enough delegates—typically there are only one or two from each of the islands—so that they could parcel out attendance at the various meetings. As a result, they were able to attempt for the first time to get coverage at the various meetings, some of which run simultaneously.

And then one last anecdote, this one is about Dominique. At the start of summer last year I was talking with an agricultural exporter in Dominque who told me about his frustrations in trying to export mangos into the U.S. market. This was not an issue of tariffs; this had to do with the inability to absorb the cost of placing or posting a U.S. agricultural inspector, which would have to take place at their own expense each and every time they wanted to send a shipment of mangos into the United States. That is what they were being required to do.

I share these stories because I think they illustrate the capacity concerns and can provide a backdrop to the discussion and the presentations—mine, as well as the others'. These are all examples from the Caribbean, of which I am most familiar, but these are issues common to other developing countries and regions.

So where are the negotiations? What is going on? I do not want to assume what people know or do not know, and I will be happy to elaborate in the question-and-answer session. After the initial ambitious agenda, the negotiations were scaled back to four main areas: agriculture, industrial access (non-agricultural market access is what it is actually called), services and trade facilitation.

We have followed the issue of agricultural markets because it is the most visibly contentious issue to date and has been receiving a lot of attention in the media recently. The goals there are what are known as the "three pillars":

(1) Reduce domestic subsidies—Here the U.S. subsidy is considered the biggest culprit.

(2) Eliminate export subsidies—There has been agreement on this. The European Union has been considered the biggest culprit in this regard.

(3) Improve market access through tariff reductions—Here again the EU has been considered one of the biggest culprits, but there has also been a focus on the emerging economies and developing country markets.

These are the three pillars of the agricultural forum agenda for the Doha Round.

In regard to nonagricultural market access, the focus is on tariff reduction. This is important. Tariff reduction is being tied to the reform of agricultural markets because this is where the U.S. and the EU in particular are looking for tradeoffs from emerging economies; Brazil and India are the two in particular that everybody is focused on. The hope is that Brazil and India will significantly reduce their tariffs and give foreign companies enough access to their industrial markets so that the U.S. and the EU can go back to their domestic constituencies and say that this is what they received in exchange for giving up tariffs and reducing some of their agricultural subsidies.

A similar situation exists with respect to services, which is the third sector. All sectors have been open for discussion, and here too the focus on the part of the U.S. and EU is to get greater access to the services market in a number of the emerging economies. I should say not much progress has been made in this area.

The fourth area is trade facilitation, which is the development of new rules to streamline trade and customs procedures. These are the four main areas of negotiation.

I would like to touch briefly on an issue that has been in the news lately. Much has been made of a reported breakthrough with respect to the agricultural negotiations between the U.S. and the EU. Just to back up a little: on the one hand, the U.S. found that the EU had reduced its tax, and the U.S. has been very unhappy with tax offers

made by the EU. For example, I have seen a report that says the European Union offered to cut its average farm tax by 50 percent. The U.S. wants the average farm tax in the European Union to be cut by 60 percent. Apparently these recent talks between the U.S. and the EU are now looking at maybe a cut of 54-to-58 percent. We will see whether that happens. That is one side of the coin.

On the other side, the European Union wants the U.S. to cut its domestic subsidies and has been unhappy with the offers that have been made by the U.S. to date. Thus, these recent talks between U.S. and the European Union and the indications that we may be reaching some agreement around this specific issue are certainly positive signs. But, at the same time, what we are talking about realistically is the possibility that this will signal that there has been enough movement in the negotiations to allow for the extension of trade promotion authority, as mentioned earlier. Trade promotion authority requires the U.S. Congress either to reject or to accept the trade agreement in its entirety: it cannot modify it.

Let us reflect a bit: certainly most negotiating partners of the U.S. consider it important for trade promotion authority to be in place since they otherwise cannot be sure that the package they negotiate with the United States will be passed by the U.S. Congress. People want a certain amount of certainty and the assurance afforded by the trade promotion authority. That authority expires on June 30, 2007. And so the question is whether Congress, particularly a newly elected Democratic Congress, will be willing to extend trade promotion authority. Because of what I think is the significance of the signals sent by these negotiations between the U.S. and the EU on the agricultural issue, the Congress should be encouraged to extend trade promotion authority, perhaps even just for the purposes of the Doha Round. [*Editor's note:* The trade promotion authority was not extended by the Congress and therefore expired on June 30, 2007.]

But, as I said, this is just the beginning. There are a number of issues outstanding. For instance, even if the U.S. and the EU reached an agreement on agriculture, would the EU agree to lower its tariffs significantly enough, and would the U.S. agree to cut its subsidies significantly enough, to encourage Brazil, India, China, and the other emerging economies to make significant offers in services, services access and tariff-cutting so as to give the U.S. and the EU access to their industrial markets? And then there are questions about whether or not the U.S. and the EU domestic constituencies are going to accept this. France has been extremely adamant about sticking to the EU's internal timetable for reform of its cap policy, to which it does not anticipate any changes before 2013. And what about the U.S. farm bill? We have been hearing a number of statements from U.S. Congressional representatives about planning to extend the U.S. subsidies that currently exist under the U.S. farm bill.

Let me touch briefly on one other issue that gets me back to the anecdote that I shared earlier: it relates to capacity concerns in developing countries.

The issue has to do with tariff reduction. In my very humble opinion, there are many questions about what the Round as currently structured can actually bring to a number of developing countries. As the story that I shared with respect to the Dominique mangos shows, the products of a number of developing countries—the majority of them actually—can already access certainly the U.S. market, and those of African and Pacific countries can also access the EU market.

What is left? The barriers that face them are the sanitary and Phytosanitary (SPS) measures, and technical barrier to trade (TBT) issues. The renegotiation of the SPS agreement is off the table for the Doha agenda, and the TBT issues are being tabled in a number of cases.

With respect to access for industrial goods, developing countries wanted time to study the effect of previous liberalization from structural adjustment programs and to get credit for the liberalization that they have done in the past in this realm. This has been taken off the table.

Services tend to be a mixed blessing. For the most part, except for some of the larger Latin American economies, they tend not to be very competitive. So liberalization in the services sector tends to be about greater access for foreign service suppliers, which is actually a mixed blessing, as I said. It has to be good for consumers. I know that certainly in the expansion of telecommunications service providers in the Caribbean this has opened up an entirely new world for consumers, for businesses and so on. But on the other hand, the issue of most interest to developing countries is the movement of skilled people, and this issue is not on the table at all at the Doha negotiations.

In trade facilitation we have the ironic situation in which importers, traders, businesses and so on will actually benefit, in my opinion, from new rules that provide more streamlined procedures for import and customs procedures. But on the other hand, governments are concerned about taking on yet another set of issues for which they can be held accountable. Meanwhile, they are still struggling to implement the commitments and obligations that they took on in the Uruguay round.

So looking forward, I think that success is possible and that the issues can be negotiated. But what is needed is time. The December 2006 deadline has obviously now been moved. All the existing deadlines for the Doha Round have been predicated upon the expiration of trade promotion authority. I think that is a deadline that does not provide sufficient time to address the capacity concerns of developing countries. It does not provide sufficient time for them to develop their own negotiating posi-

tions. And in fact, as the U.S. and EU talks suggest, it has not even provided enough time for developed countries to resolve these conflicting and competing interests that must be addressed, and a compromise must be found in order for the round to progress.

So I think what is being talked about is a 2008-2009 deadline. I think that this is a realistic deadline that would allow for meaningful participation by developing countries, allowing them to articulate and advance their own interests for a really full contingent to the Doha Round. Thank you.

C. The U.S. and Doha

MR. CHARLES DORKEY: Thank you very much.

I am going to divide my talk into two parts, a little background on the U.S. economic environment, a general view on trade, and then specific comments on Doha.

Although there are minority opinions, the general view is that open trade is very good for the United States and has been very good for the United States during its history. Our economy is based on competition, and all of you lawyers here in New York City know how much competition we are faced with when we have open markets, which are critical to the effective allocation of natural resources and providing economic opportunities and incentives to growth.

It has been central to the efforts of the United States to support and strengthen healthy competition. We have promoted consistent trade policies since 1934 to lower and eliminate barriers and distortions to international trade on a reciprocal basis. We believe in the advent of a rule-based multilateral system. GATT and its evolution and the expansion of the WTO are contributing importantly to strengthening competition and helping to improve the U.S. economy, as well as that of other members.

Since the 1995 inception of the WTO, the U.S. economy has sustained strong growth. From 1995 to 2005, our economy has grown at an annual rate of nearly 3.3 percent. The growth has been accompanied with expansion in employment. The rate of unemployment is now 4.5 percent, down from 6.1.

We have been recovering from a period of little growth in the early 2000s. Real exports of goods and services expanded by 7.6 percent per year and real imports by 8.4 percent per year between 2003 and 2005. As we all know, we have a large deficit between goods and services. In 2005 the deficit was $724 billion, which is a meaningful number, even for a New York lawyer. There has been much concern about the size of the current local imbalance. The U.S. currently has an $805 billion account deficit. Despite this, our economy has performed well.

The United States believes in an open market and allows people access to our markets. Our average tariff rates are about four percent. In 2005 nearly 70 percent of all U.S. imports entered the country duty-free.

The U.S. services market is open to competition, as witnessed by many of the lawyers in other parts of the world who have offices here, and we welcome you because it makes for a better city. The U.S. purchased up to $2 trillion of goods and services from the rest of the world in 2005. We continue to be the largest host of foreign direct investment, raising $1.5 trillion. U.S. affiliates of foreign companies employ more than five million U.S. workers. The U.S. is committed to keeping itself as an attractive destination for foreign investment.

The United States is committed to the WTO. A multilateral trade system is at the heart of the U.S. trade policy. The U.S. has a great belief in the ultimate success of Doha as being vital to the U.S.'s vision of a more prosperous economic future for itself and its trade partners. However, we have a long way to go. And in many things, as you know, negotiations from time to time are difficult, but I think the present administration, at least, believes that this can successfully be achieved.

As you know, because of disputes in agriculture talks, they have been suspended. The core group of the WTO, which is the G6—consisting of the U.S., EU, Brazil, India, Australia and Japan—reached an impasse over specific methods to achieve the broad aims of the round of agricultural talks. The U.S. only has a 12 percent average tariff in agriculture, compared to foreign tariffs with an average of 62 percent. Our market is relatively open. I think some of our competitors would like it to be more open or don't necessarily agree with that assessment, and I will allow them to make their case. We as a general matter want a more level playing field in trading generally and in agriculture in particular.

The U.S. has indicated that it would reduce trade-distorting, domestic subsidiaries to U.S. farmers. The U.S. felt that the EU would not match such reduction by reducing its tariffs on agricultural products. The U.S. proposal addressed domestic support in improving market access, and our negotiators believed that the EU reform proposal was insufficient.

As we see it, the EU is the largest user of export subsidies and is opposed to setting end dates for the use of such subsidies. That is an issue for the U.S. Senate.

The current farm bill is expiring. We have obligations under the existing agriculture agreements that will limit some trade-distorted spending by about $19 billion annually. There are, as you know, tremendous political crosswinds in this country, and it is sometimes very difficult to get things done with the agricultural community.

The U.S. wants developing countries to reciprocate on trade concessions. We have made an ambitious offer for reductions in the domestic support of trade. It has not been matched by any market opening for agricultural and industrial products by either Brazil or the EU. Our trade representative has said, for instance, that there are some developing countries that still have not come to grips with the importance of opening up their markets.

The U.S. also wants, as mentioned earlier, significant market access for nonagricultural goods. The agricultural group of exporting countries, meeting in Australia in September of 2006, called for resumption of the round. The U.S. continues to offer flexibility, modifying its agricultural proposal to revive suspended negotiations.

Since talks have ended, the U.S. has made efforts to reduce spending on the most trade-distorted domestic support for farmers if the EU would make what we would consider to be an audacious on cutting agricultural tariffs. We have not seen that the EU has done that. As has been mentioned, Congress will need to extend the president's trade promotion authority, which will expire.

I would say that, for those of you who watched television last night, it is not clear that Congress and the president are going to get along very well in the next two years. So, I think there are many other things on the plate for the administration and for Congress, and I am just not sure that this is one that is going to reach the level of significance to achieve success. However, President Bush did say on January 5th, "I believe we can get a deal done," and his special trade representative has been more optimistic that deals can get done. These comments reflect that there have been conversations going on in the last several months that have been in-depth and productive, that they are not near a breakthrough but progress has been made.

I now turn this over to our next speaker. Thank you.

D. The EU and Doha

MR. ANDRE BYWATER: Ladies and gentlemen, good afternoon. My name is Andre Bywater. You can deduce from that that I am half-English and half-French. I hope you will not hold that against me. I am going to be talking to you a little bit this morning about some of the underlying issues that the EU is dealing with, the background, if you like, to some of the Doha issues.

What is the EU's stance? That is what I will open with. I will talk to you a little bit about the enlargement of the EU, particularly in the last round and the most recent round as well. And I will look a little bit to the future. Then I will do a little nod to a particular issue that the EU is dealing with at the moment in terms of reviewing its trade policy, and then I will finish with a few words about lateral deals. This seems to be one of the major criticisms of the impasse concerning Doha.

So what is the EU's current position on Doha? Well, my two co-speakers, I think, have well put the boot into the EU's position. I think we all get the message. We all understand that agriculture is very much the issue. While we criticize that, I think it is certainly a very narrow issue that the EU is dealing with.

The question I ask is, Is this affecting EU trade policy in other ways?—for example, through its trade-defense cases? Or is it in fact the other way around? Is its approach or stance in all the trade cases feeding into its approach to Doha? And then we have to ask ourselves whether the EU is actually doing anything in terms of reconsidering its trade policy or whether the EU is doing anything to promote free trade.

I have a picture here of our trade commissioner, I apologize for the quality. It is supplied by my uninvited co-conspirator, Jonathan Armstrong, in the audience. The big question is which way is he going to swing? Where are we going? As we heard very recently, we believe that there may be a breakthrough, but I think we have to step back to a speech that the trade commissioner made in November, where even he called it the narrow window of Doha success. He identified three issues.

First of all, the EU's negotiating position is that it has to be accepted that negotiations must resume where they broke off. What was he saying? Well, there is no realistic alternative to resuming where we left off in July on tariffs and subsidies concerning agriculture. Every move away from the emerging consensus, centered around those G20 developing countries, will make the eventual agreement harder to reach.

Position number two: Make the economic case for the deal on the table. Where the Uruguay round agreed on an average tariff cut of 36 percent, the EU is talking about a 50-percent cut. And where Uruguay allowed countries to protect farm products behind average cuts, Doha has already agreed to a system that will cut high tariffs most and in which every single product will be cut, with no exceptions.

Point three: Prepare the grounds technically and politically. We are told by the trade commissioner that the EU will renew its willingness to improve its farm tariff offer by adding substantially to the 39 percent it offered before. And Mandelson said that the EU is ready to add more than ten percentage points and get within close reach of the average farm tariff cut demanded by developing countries in a way that demonstrably gives access to the U.S. and other agricultural exporters. So I think the thing is very clear. It is the A word: agriculture, agriculture, agriculture. That is where the EU is very much digging its heels in.

So, it would appear at one level that, as I said before, in concentrating all its efforts on agriculture, the EU's

window seems to be very slanted. Does this smack of good old protectionism, good old, bad old Europe? Or does EU trade policy, in terms of its defense instruments, actually reflect the Doha position? Well, let us just remind ourselves of those trade defense mechanisms, as this may be a first indicator of protectionism.

The EU, like the U.S., is a major user of trade defense mechanisms: anti-dumping, anti-subsidies and safeguards. On the average, the EU imposes some twenty anti-dumping measures per year. Now recent reports have stated that, despite the global trend in the reduction of anti-dumping trade investigations, the EU has actually increased the number of cases that it has begun in the last two years, only to be surpassed by India.

So what is feeding into this? Well, one thing we have to bear in mind is the enlargement of the EU. Two years ago ten new countries joined the EU: the Baltic states, central and eastern European countries and two from the Mediterranean. The thing you have to understand in EU defense cases is this: Although the European Commission is the bureaucracy that actually conducts the investigation and will present its proposals, at end of the day it is the EU member states that vote on whether to adopt trade measures or not. And rather uniquely in the EU, the trade defense is voted on by simple majority. So you only need one member state, out of what is now 27, to shift the balance. That could be little Malta, which is not even one million people strong. Little Malta has got one vote, the same as Germany, about 82 million people: one vote.

There is nothing to hide here. It is a very politicized process. That is very well-known. A number of EU countries—for example, France and Italy—are very protectionist. Other EU countries are far more supportive of free trade; these include Denmark, Sweden and the UK.

If we look at these ten new member states that joined two years ago, what is their record in terms of the votes and who is really leading the pack? Well, Poland was the largest of the new EU member states, and it joined two years ago. Let us just remind ourselves where Poland is. It has neighbors such as Russia, the Ukraine, and Belarus. These are some of its trading partners. And in a number of respects it has led the pack in a number of these cases.

A case I worked on concerning potash, which I remind you is an agricultural fertilizer from Russia and Belarus, was a review case that was conducted last year. From my inside understanding of the case and from my dealings with people involved, it was made very clear to me that the ten new EU member states were actually opposed to renewing the duties in this particular case. But the European Commission in its cleverness came up with a compromise plan which eventually everybody accepted, and so the duties were renewed.

So in this case, Poland was very clearly against duties all the way to the end. But on the other hand, we have seen Poland leading in cases to bring anti-trade measures. For example, we had a safeguard case concerning frozen strawberries from China. (I did not know you could get them there or in Poland.) That was a case instigated at Poland's request, and it actually ended up as an anti-dumping investigation.

So we have got new EU member states. Let us give them a little bit of time. They only joined the EU a short while ago. The voting impact is not going to change, so we have simply added two more members: again still one state, one vote. It is very uncertain whether we can say if Bulgaria and Romania will be protectionists or free-traders. They have economies that are very much in transition, a fact which might incline them to protectionism, but, of course, in order to have that, you need industries to protect.

Let us take Romania as an example here. They have 22 million people; potentially they are a significant economy, and they also have a very large agricultural sector.

So what are the other countries involved in this EU enlargement process? With Croatia, negotiations going on. The same is the case with Macedonia, as well as with Bosnia and Herzegovina. With Serbia, negotiations have stalled because of war-criminal issues. Montenegro, our newest country in Europe, became a country last year. Albania may be joining. Kosovo, not a country of course, is a U.N. protectorate; it may become a country this year; we shall see.

The EU has been active in promoting free trade in the Balkans: it pushed an agreement between a number of these countries. Although the EU is not party to the treaty involved, it has been very much the instigator because it sees this as the way forward in terms of liberalizing trade between these countries, and it is very much seen as a stepping stone for these countries in joining the EU. And it also makes the region much more attractive for indirect investment. This agreement is designed to foster trade liberalization, but it has not been able to stop these countries from bringing trade cases against each other. Last year I understood there were cases brought by Balkan against Croatia for beer, dairy products and so on.

Everything is stalled in Turkey at the moment; this has all to do with the trade issue, Turkey having dropped its ports for access to Cypriot ships. Our near neighbor, Belarus, does not want to join the EU although it might; Moldova also might. Ukraine might like to join; Russia, probably not.

And we have a lot of trade-defense cases against these countries. For example, with regard to Belarus, we recently withdrew the special generalized trade references on the basis that Belarus has violated various labor rights.

I think respect for the rights of labor is a key component of EU trade deals, and I think we will see more of that in the future.

Russia, as you know, has been flexing its muscles on gas prices and gas lines, but, on the EU trade defense side, they lose out, because they supply cheap gas to their own domestic producers. But as we have seen in a number of cases, like the potash case I mentioned above, they actually lose out because the EU does not agree that they are supplying proper cheap gas in the sense they have some sort of competitive advantage.

The EU is reviewing its trade policy. As I said, they are trying to take into account globalization, and they realize that there is a challenge there. With regard to actual deals, at the beginning of the year we heard from the *Financial Times* that negotiating positions appeared to be inflexible, particularly on agriculture. The ensuing vacuum appears to have be filled by bilateral deals. And we are told that the EU is now following the primrose path that the U.S. has followed, lining up various countries for bilateral deals.

The conclusion is that the U.S. has been pursuing this for some time. Has it put momentum behind the Doha? No, it has not. Asia has been pursuing these types of bilateral deals for decades. Has this helped economic integration in Asia? Again, no, they have not. The fact is, according to the *Financial Times,* there are only two types of trade liberalization that regularly and predictably have significant effects: the unilateral, the do-it-yourself deals and the multilateral ones, where you get everyone else to do it.

So, as we have heard, there tends to be one theme at the EU: agriculture, agriculture, agriculture, and this is perhaps not helped by these bilateral deals. On the one hand, the EU trade defense activity, despite a number of agricultural features, does not necessarily seem to be running the show in terms of Doha. As for the future, we will see whether the EU gets more protectionist or not with its new members. The EU is trying to review some of these trade defense mechanisms. Perhaps in conclusion, it would seem, I hope, from what I have presented, that the EU has a bit of a schizophrenic approach: on the one hand clinging to the—pardon the agricultural pun—the sacred protectionist cow of agriculture, pursuing these bilateral deals, while, on the other hand, it is also promoting free trade in its own backyard and trying to review these issues through its trade mechanisms. Thank you very much.

E. Latin America and Doha

MR. RICARDO RAMIREZ: Good afternoon. I will speak about the Latin American experience with regard to the Doha Round.

Let me say, just as a footnote, that I will not talk about the forecast of what is going to happen with the Doha Round because I think my co-speakers already gave a good overview of what might happen. I intend to discuss the role Latin America is playing in the context of the Doha Round.

Free trade in the Americas goes beyond NAFTA. There are more than 32 free trade agreements involving at least one Latin American country. How important are those agreements? Well, in terms of trade, for Mexico, for example, 90 percent of all trade is with a country with whom a free trade agreement has been signed. In recent years the United States, Europe and Japan have been increasingly negotiating free trade agreements. Just two or three weeks ago, Colombia and United States signed a free trade agreement.

How important are those agreements in terms of what they cover? Maybe some of these agreements are with what we call last generation agreements, which cover areas that go more beyond the areas that are being negotiated in the Doha Round. Just to give you examples, those agreements cover areas such as investments and government procurement, which are not being negotiated in the Doha Round, as well as investments.

So all of this raises the question why does Latin America care or should Latin America care about Doha? Maybe it is not so bad that the negotiations are going so badly. Maybe that is a good thing. After all, Latin American countries are negotiating bilaterally with most of their neighboring countries, so why do they need to care about the Doha Round?

Well, despite that, the purpose of this presentation is to highlight that the opposite is true, which is to say, Latin America does care about the Doha Round and has something to gain for itself from the Doha Round. I will quickly go through at least the major topics of the Doha Round and try to put this in context.

In terms of agriculture, as my previous colleague have said, it is about agriculture, agriculture, agriculture, so it is clear that the success of the round rests on what happens in the area of agriculture. What role has Latin America played in agriculture? Well, Latin American countries are members of the group called G20, and Brazil, Costa Rica, Colombia and Mexico have participated especially actively in that group.

This G20 group was created to counteract the intention of the United States and the European Union to dominate agricultural negotiations. The goal of the G20 is to ensure that export subsidies are ended by the year 2013 and that a constructive approach in relation to the most controversial aspect be taken, which is the issue of domestic subsidies. I would like to point out something that has gotten a lot of press in Mexico, and it involves what the

taco man calls tortillas. There is a discussion in Mexico about the tortilla price going up. We bought most of the corn from the United States, and that corn benefits from subsidies; that corn is cheap. I do not need to tell you that the Mexican's foremost food is the tortilla. Moreover, the textile industry benefits from U.S. subsidies for cotton. So that poses an additional question, are the subsidies so bad for us?

A reduction in tariffs will benefit not only Latin American countries with a more industrialized platform, such as Chile and Mexico, but will also mean access for other markets such as those in India or China. Also, as you may know, Mexico exports a great deal of cars, so the fact that Mexico can gain access to other markets would be really beneficial for Mexico.

The issue of services is the most controversial, at least coming out of the last ministerial meeting that took place in Hong Kong. Since I was still a government official at that time, I attended that meeting, and Venezuela and Cuba made a really strong statement against the services negotiations. Perhaps some Latin American countries forget that two-thirds of the trade of some Latin American countries (for example, Chile and Mexico) consists of services. I am not including Panama, where basically all the trade consists of services. This is one reason why the services sector is very important for Latin American countries—not only with regard to what are perhaps more formalized services, such as services rendered by medical professionals. For example, recently Latin America has become an great exporter of television services. There was a television comedy called "Ugly Betty." "Ugly Betty" was written in Colombia then taken to Mexico, and just weeks ago it won a Golden Globe award in the United States.

"Trade facilitation" is a term that does not say much; it is kind of an obscure name. I would describe it as relating to customs clearance and other issues that help foster trade. Costs in the customs clearance and transit of foods amounts from two to fifty percent of the price of the food. Moreover, for countries like Paraguay, who do not have access to a port, trade facilitation not only represents negotiations issues but, more importantly, a key element of their export potential. Countries need to be more efficient in securing customs clearance procedures. This is an issue as to which all of Latin America has concurred and even put together a proposal for the Doha negotiations.

As for anti-dumping, there is no country, except for the United States and maybe Europe, that will not work to negotiate an anti-dumping agreement. In Latin America we are divided here. On the one hand, we have Chile, who wants to replace the anti-dumping regimes with competition, and, on the other hand, we have Mexico and others who would prefer more of a refining of the anti-dumping agreement approach. Since there is not going to be an agreement here, anti-dumping and subsidies have been dealt with by WTO tribunals.

Finally, there is the issue of dispute settlement. Latin American countries have been an increasingly frequent user of the WTO dispute settlement mechanism. Since 2004 at least one Latin American country has been participating in half of all the disputes before the WTO. These Latin American countries have put forth proposals to clarify and improve these mechanisms. For example, Mexico has made several proposals aimed at addressing the issue of compliance by a member affected by any one measure. Under the current system the only remedy you have when you initiate a WTO dispute is that the violating member will withdraw the measure. There is no remedy of an award of damages under the WTO. So a country may have endured four years of violative measures, and the other country will simply say, "I'm sorry," and that is the end of it. Argentina, Mexico, and Brazil have put forth proposals in this area.

So should we care about the Doha Round? Yes, and we do care. Thank you.

F. Impact on Developing Countries

MR. HAMILTON: We are now open for questions.

AUDIENCE MEMBER: Do you think that, with the inevitable rise in corn production to meet the ethanol campaign, the price of corn will rise? Will that ultimately help the poor Mexican small farmers, because they will get a better price for the corn in Mexico? Is it a two-edged sword?

MR. RAMIREZ: Well, there is a discussion of what is going to happen with this ethanol or what we call these biodiesel products. What may happen is that farmers will grow corn to make ethanol rather than to make tortillas. So that is a big question now. We do not know how that will play out. Maybe these subsidies on ethanol will encourage the production of this kind of energy alternatives.

AUDIENCE MEMBER: With a French election coming up and then an American presidential election coming up—where the closer you get to the election, the more power the individual states have—does this realistically preclude an agreement prior to the election of the next French and U.S. presidents?

MR. BYWATER: I will speak from the French perspective. As you may know, for any French politician to go against the farmers is political suicide. We have two candidates, probably two main candidates, although I have not seen any statements from either of them about agriculture. Certainly one of those two candidates is a different type of candidate. He set out to reform a lot of things in France. You never know, he may go a different way, but it is going to be very, very difficult for

him. France is not the only country of course that wants to support its agriculture. There are other European countries as well. It is going to be difficult because the European Commission negotiates on behalf of all the member states, and so it needs to get the consent of the member states in terms of moving forward. So from the EU side, I think it is going to be very difficult. I do think the EU is going to dig its heels in with regard to agriculture, whether it be France in the forefront or another country.

MS. EWART: If I could respond to this as well. From everything I have heard from Washington D.C., from people on Capitol Hill, people who are behind the negotiations, there is an expectation that there is not going to be an actual breakthrough before 2008-2009, in large part because of just how difficult it is going to be to get the number of competing issues resolved. So I agree.

MR. BYWATER: Also, remember all of these new countries that joined the EU joined because they want money for their infrastructure, and many of them also want want money for their farmers. Something like a quarter of the people farm the land. So they have not joined a club where suddenly everything is going to be taken away from them instantly. It is going to take time.

MS. EWART: Maybe what I could do is just address a couple of points that were made by the other panelists. In particular, two points: First, Ricardo raised a question about corn subsidies. Are U.S. subsidies that bad for Mexico since they allow Mexico to import corn cheaply? These are some of the issues that make the round so difficult, because the answer is yes and no. It depends on whose perspective you are looking at. From the perspective of consumers, yes, certainly, they are a good thing. The consumers are very happy to be able to buy cheaper corn, cheaper milk, cheaper rice, or other cheaper products. The U.S. subsidies are destroying the agricultural sectors in a number of developing countries while consumers are benefited. Well then what about the industries? Are there some viable sectors that are being destroyed or harmed because they are no longer able to compete? These are some of the issues that developing countries still have to come to terms with. Therefore, there is a need for time and reason, so I do not think a postponement to 2008 or 2009 for the Doha Round is a negative. I actually see it very much as a positive.

MR. HAMILTON: All right, if there are no other questions, let me thank our panel. You had a window into some of the institutions that work well within the U.N. And I just hope that every time you do get an opportunity to critique on one side what they are not doing correctly, you do not forget some of the things they do correctly.

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The Territoriality Principle and Protection for Famous Marks in the Americas

By L. Donald Prutzman

I. Introduction

Under the prevailing internationally recognized principle known as "territoriality," trademark rights typically exist in each country only within the borders of that country and only to the extent protected by that country's trademark law. For this reason, with some exceptions created by international agreements, such as the Community Trademark covering the entire European Union and the Andean Pact covering member Latin American nations, trademark owners must protect their marks in each country where they need protection, usually by registration there. As a general rule, a trademark that its owner ("Owner A") has protected in certain countries can be adopted, used and registered by an unrelated party ("Owner B") in a country where it has not been protected. This is true even where Owner B knows of Owner A's usage of the mark and is consciously attempting to appropriate the goodwill of Owner A's mark in a country where that mark is known to the relevant class of consumers. This situation fosters consumer confusion and possible damage to the goodwill of Owner A's trademark, and leaves Owner A unable to expand operations to a country where its trademark is known because a usurper already has the trademark there.

Because of this obvious problem with the rigorous application of the territoriality principle, the need for an exception, or countervailing principle, to territoriality, known as the "Famous Marks Doctrine," has long been recognized. In theory, the Famous Marks Doctrine affords protection to a trademark in a country where it is neither used nor registered, but where it is well known to the general public or at least the relevant class of consumers of the goods or services involved. However, the Famous Marks Doctrine is not typically part of a nation's internal trademark legislation, and a recent important appellate decision in the United States has held that it is not part of U.S. trademark law. The Famous Marks Doctrine is, however, embodied in, and applies through, international agreements.

The most important and well known such agreement is the "Paris Convention for the Protection of Industrial Property" (the "Paris Convention").[1] As discussed in more detail below, Article *6bis* of the Paris Convention affords protection under the Famous Marks Doctrine for trademarks (in the word's narrow sense of marks used for goods, as opposed to services). Article 16(2) of the Agreement on Trade-Related Aspects of Intellectual Property Rights (the "TRIPS Agreement")[2] expanded the reach of Article *6bis* to service marks. Most Latin American countries, as well as the United States, are signatories to the Paris Convention and the TRIPS Agreement. However, as discussed below, a recent court decision in the United States has held that, notwithstanding the treaties, the Famous Marks Doctrine generally and Article *6bis* in particular are not part of United States trademark law.

There is, however, another international agreement among the United States and a handful of Latin American countries that embodies the Famous Marks Doctrine—the "General Inter-American Convention for Trademark and Commercial Protection of Washington, 1929" (the "Pan American Convention").[3] Articles 7 and 8 of the Pan American Convention provide a very broad form of Famous Mark Protection that, as discussed in more detail below, does not even require that the mark be "famous" to be protected. The treaty requires only that the usurping user knew of the owner's use of the mark in another member country. Articles 7 and 8 of the Pan American Convention are unique, little-known provisions that have not been widely used. They are likely to assume much greater importance, at least for U.S. and Latin American trademark owners, as a result of the holding that Famous Marks protection under the Paris Convention and the TRIPS Agreement is not available in the United States.

II. Territoriality

"Territoriality"—the concept that trademark rights exist separately under each country's law—is a basic principle of U.S. trademark law[4] as well as the trademark law of most nations. Under the territoriality principle, use of a mark outside a country does not give the user any rights to use the mark, or to stop others from using it, in that country. This is true even where the user in that country is acting in arguable "bad faith" by not only using the mark but also adopting trade dress and other elements used by the foreign user in an attempt to create the impression that the user is associated with the foreign trademark owner.

Under the territoriality principle, a trademark has a separate legal existence under each country's laws, and its proper lawful function is not necessarily to specify the origin of a good or service, but rather to symbolize the domestic goodwill of the domestic trademark owner so that the consuming public may rely with an expectation of consistency on the domestic reputation earned for the mark by its owner, and the trademark owner may be confident that his goodwill and reputation will not be

injured through use of the mark by others in domestic commerce.[5]

There is a countervailing theory to the territoriality principle called the "universality principle." Under that theory, "if a trademark [is] lawfully affixed to merchandise in one country, the merchandise would carry that mark lawfully wherever it went and could not be deemed an infringer although transported to another country where the exclusive right to the mark was held by someone other than the owner of the merchandise."[6] The universality principle is definitely not part of United States trademark law[7] and has not found much acceptance anywhere else in the trademark context.[8]

III. The "Famous Marks Doctrine"

As noted above, rigorous application of the territoriality principle would allow an unrelated person to adopt a trademark that is well known in countries where it is used and protected in a country where it is neither used nor protected. The "Famous Marks Doctrine" has developed to address this problem. Under the Famous Marks Doctrine, a mark may be entitled to protection in a country even if neither used nor registered there if it is well known among consumers in that country. It may not be necessary for a mark to be well known to the general public. Wide knowledge among the relevant class of consumers for the goods or services involved (known as "niche fame") may be sufficient.

As the one United States federal court ever to apply the Famous Marks Doctrine, the United States Court of Appeals for the Ninth Circuit,[9] explained:

> [T]here is a famous mark exception to the territoriality principle. While the territoriality principle is a long-standing and important doctrine within trademark law, it cannot be absolute. An absolute territoriality rule without a famous-mark exception would promote consumer confusion and fraud. Commerce crosses borders. In this nation of immigrants, so do people. Trademark law is, at its core, about protecting against consumer confusion and "palming off." There can be no justification for using trademark law to fool immigrants into thinking that they are buying from the store they liked back home.[10]

In *Grupo Gigante,* the plaintiff operated a chain of grocery stores in Mexico under the trademark "Gigante," but neither used nor protected that mark in the United States. An unrelated entity appropriated the mark for grocery stores in Los Angeles, California, an area with a significant concentration of Mexican immigrants. The Mexican trademark owner sought to stop the junior user from using the mark. The court invoked the Famous Marks Doctrine to do so without grounding its use on any provision of United States trademark law or any international agreement to which the United States is a party.

State courts in the United States have occasionally invoked the Famous Marks Doctrine in deciding state common law unfair competition cases. The seminal case was decided in a New York state court. In *Maison Prunier v. Prunier's Rest. & Cafe,*[11] the owner of "Maison Prunier," a famous Paris restaurant with a branch in London, but no operations in the U.S., sued the operator of a New York restaurant that had adopted the Prunier name and a slogan used by the Paris Prunier, and was advertising itself as "The Famous French Sea Food Restaurant." The New York court granted an injunction. The court acknowledged the general rule of territoriality, but held that there was an exception for foreign marks that were well-known in the U.S. where the U.S. user was acting in bad faith by leading the public to believe that it was connected to the famous foreign mark owner. The holding was based entirely on New York common law unfair competition, and not U.S. trademark law.

The doctrine was recognized again in *Vaudable v. Montmartre, Inc.,*[12] another New York state court case. That case also involved a famous Paris restaurant, Maxim's. The court enjoined operation of a New York City restaurant called Maxim's that had also adopted the decor and other trade dress of the Paris restaurant. The court concluded that the French trademark owner had priority in the U.S. against a junior user based on (1) uninterrupted use of the mark outside the U.S., and (2) the fame of the mark among the relevant class of consumers.

The Trademark Trial and Appeal Board[13] has also recognized the existence of the Famous Marks Doctrine in several decisions,[14] but has actually applied it in only one case. In *All England Lawn Tennis Club, Ltd. v. Creative Aromatiques,*[15] the Board upheld an opposition by the operators of the Wimbledon tennis facility and tournament to registration of the mark "Wimbledon" for cologne in the U.S. Even though the petitioner was not using the Wimbledon mark on any goods or services in the U.S., the Board held that it had the ability to oppose registration based on the rationale of *Vaudable* because consumers would believe that the cologne was sponsored or approved by the operators of the famous tennis tournament. However, the Board did not ground its recognition of the Famous Marks Doctrine on any provision of federal trademark law or any international agreement. It relied solely on a state law unfair competition theory.

IV. Is the Famous Marks Doctrine Part of United States Domestic Trademark Law?

As noted above, those state courts that have applied the Famous Marks Doctrine and the Trademark Trial and Appeal Board have all based their decisions on state unfair competition law, not United States trademark law.

The one federal appellate decision to apply the doctrine, *Grupo Gigante,* did not cite any provision of federal trademark law in support. Recently, the United States Court of Appeals for the Second Circuit[16] held that the Famous Marks Doctrine is not, in fact, a part of federal trademark law, even though it is embodied in a treaty the U.S. signed. According to that court's decision,[17] any possible application of the doctrine in the United States would only be pursuant to the unfair competition law of a particular state.

ITC involved the use of the trademark BUKHARA for Indian restaurants. The plaintiff ITC owned and operated well known Indian restaurants under that mark in India and elsewhere. It had formerly operated several Bukhara restaurants in the U.S., all of which had been closed, and had an existing U.S. trademark registration for BUKHARA. The defendants observed that ITC was no longer using the mark in the U.S. and decided to open two restaurants in New York under the mark BUKHARA GRILL. The defendants' restaurants "mimic[ked] the ITC Bukharas' logos, decor, staff uniforms, wood-slab menus, and red-checkered customer bibs,"[18] and so they were obviously trying to trade on the fame of the foreign restaurants of the same name.

The trial court had decided in favor of the defendants. On appeal, the Second Circuit first disposed of plaintiffs' claim that defendants' use of the mark infringed plaintiffs' existing U.S. registration. The court affirmed the lower court's holding that by closing its U.S. restaurants ITC had abandoned its U.S. mark, so that the registration was subject to cancellation and was of no assistance to the plaintiff.

The court next considered whether the Famous Marks Doctrine applied to protect the mark in the U.S., even though it was not being used there and its registration was invalid. The court evaluated three possible ways the doctrine could apply: (1) the possible application of the "Famous Marks Doctrine" as federal trademark law; (2) the possible application of Article *6bis* of the Paris Convention (referred to above and discussed in detail below); and (3) the possible application of the Famous Marks Doctrine as state unfair competition law.

The Second Circuit first determined that, notwithstanding the Ninth Circuit's decision in *Grupo Gigante,* the Famous Marks Doctrine is not embodied in United States trademark law. The court declined to follow the Ninth Circuit expressly because that court did not ground its recognition of the Famous Marks Doctrine in any provision of federal law or on any treaty provision. The doctrine was recognized solely as a matter of sound policy. Although the Second Circuit recognized that "a persuasive policy argument can be advanced in support of the famous marks doctrine,"[19] the court found that sound policy "is not a sufficient ground for its judicial recognition, particularly in an area regulated by statute [such as trademark law]."[20] Although decisions of the Trademark Trial and Appeal Board would ordinarily be afforded considerable weight on matters of trademark law, the court also declined to follow the T.T.A.B.'s decision in the Wimbledon case, because the Board had relied on state unfair competition law, not federal trademark law. According to the Second Circuit, if the Famous Marks Doctrine is to be adopted as part of United States trademark law, it is up to the U.S. Congress to do it.

V. Article *6bis* of the Paris Convention and Article 16(2) of TRIPS

After rejecting federal trademark law as a source of the Famous Marks Doctrine, the Second Circuit in *ITC* next considered whether international treaties—Article *6bis* of the Paris Convention and Article 16(2) of TRIPS—afforded the plaintiff any protection.

Article *6bis* of the Paris Convention requires member states

> ex officio if their legislation so permits, or at the request of an interested party, to refuse or to cancel the registration, and to prohibit the use, of a trademark which constitutes a reproduction, an imitation, or a translation, liable to create confusion, of a mark considered by the competent authority of the country of registration or use to be well known in that country as being already the mark of a person entitled to the benefits of this Convention and used for identical or similar goods. These provisions shall also apply when the essential part of the mark constitutes a reproduction of any such well-known mark or an imitation liable to create confusion therewith.

Article *6bis* applies, by its terms, only to "goods." However the TRIPS Agreement expanded it to apply to services as well. Article 16(2) of TRIPS states that, "Article *6bis* of the Paris Convention shall apply, *mutatis mutandis,* to services."

These treaty provisions would seem to require the United States to recognize the Foreign Marks Doctrine, at least to the extent specified in Article *6bis,* i.e., when "competent authority" in the U.S. considers the mark to be "well known" here, the person asserting rights is from another member country, and the mark is used for "identical or similar goods." Yet the Second Circuit held these international agreements inapplicable in *ITC.*

The court, following established precedent, held that the Paris Convention and TRIPS were not self-executing treaties, i.e., that they did not become federal law by their own force, but were only effective in the United States to the extent the U.S. Congress passed implementing

U.S. legislation incorporating their provisions. The court held that Congress had not adopted any legislation implementing Article *6bis* or Article 16(2), and so ITC could not rely on these treaty provisions in arguing that the Famous Marks Doctrine should afford it protection from the defendants' usurpation of its famous trademark. The court rejected arguments by ITC that Article *6bis* was, in fact, incorporated in certain provisions of § 44 of the Lanham Act (the United States' trademark law), even if not explicitly so. These arguments had the support of the leading commentator on U.S. trademark law, Professor McCarthy.[21]

The court simply disagreed that the treaty provisions were included by implication in any Lanham Act provision, noting that "[b]efore we construe the Lanham Act to include such a significant departure from the principle of territoriality, we will wait for Congress to express its intent more clearly."[22] This holding seems to leave the United States in violation of its treaty obligations. The Second Circuit did not address that problem, but seemed essentially to take the position that, if the U.S. is not in compliance with the treaty, that is Congress's problem, not the court's.

On 26 June 2007, the plaintiffs filed a petition for certiorari asking the United States Supreme Court to review the Second Circuit's decision.[23] Grant of that petition would have given the Court an opportunity to resolve the conflict between the Second and Ninth Circuits on whether the Famous Marks Doctrine is part of federal trademark law, and also decide whether the Second Circuit correctly rejected the application of two important international treaties to which the United States is a party. However, on 1 October 2007, the Supreme Court denied the petition for certiorari and declined to review the case. Thus, at present the conflict between the circuits remains.

VI. The Famous Marks Doctrine as State Unfair Competition Law

As noted above, two quite old New York *nisi prius* decisions, *Vaudable* and *Maison Prunier,* do recognize the Famous Marks Doctrine as part of New York's common law of unfair competition. However, at the time of the *ITC* decision no New York appellate court had ever addressed the issue, nor did either of the two lower court decisions provide any guidance on how to measure or assess the fame of the foreign mark within New York, although they do suggest that niche fame is sufficient. In *ITC,* the plaintiffs argued that, even if the Famous Marks Doctrine was unavailable to it under federal law or treaty, it should be applied in support of their state common law unfair competition claim. The Second Circuit has declined to do so, at least yet.

It found that the two existing cases provided too little basis for it to predict whether the state's highest court, the New York Court of Appeals, would adopt the Famous Marks Doctrine as state law and that whether or not the doctrine is part of New York common law "is plainly an important policy issue for a state that plays a pivotal role in international commerce."[24] Accordingly, the Second Circuit decided to certify the following two questions to the New York Court of Appeals:[25]

1. Does New York common law permit the owner of a famous mark or trade dress to assert property rights therein by virtue of the owner's prior use of the mark or dress in a foreign country?

And, if question 1 is answered in the affirmative:

2. How famous must a foreign mark or trade dress be to permit its owner to sue for unfair competition?[26]

The New York Court of Appeals accepted the Second Circuit's certified questions, and answered them in a decision rendered 13 December 2007. As to Question No. 1, the court said "Yes," but expressly stated that it was not recognizing any new "famous" or "well-known" marks doctrine.[27] It held that it was simply applying New York's well established misappropriation branch of common law unfair competition law—the "principle that one may not misappropriate the results of the skill, expenditures and labors of a competitor."[28] The court said that, although *Prunier* and *Vaudable* are often heralded as "perhaps the most famous examples" of the well-known marks doctrine, they do not rely on any such doctrine for their holdings. Instead, they "fit logically and squarely within our time-honored misappropriation theory, which prohibits a defendant from using a plaintiff's property right or commercial advantage—in *Prunier* and *Vaudable,* the goodwill attached to a famous name—to compete unfairly against the plaintiff in New York."[29]

On this basis, the court held "while we answer 'Yes' to the first certified question, we are not thereby recognizing the famous or well-known marks doctrine, or any other new theory of liability under the New York law of unfair competition. Instead, we simply reaffirm that when a business, through renown in New York, possesses goodwill constituting property or a commercial advantage in this State, that goodwill is protected from misappropriation under New York unfair competition law. This is so whether the business is domestic or foreign."[30] The distinction between the court's holding and recognition of the well-known marks doctrine seems, at best, elusive. In holding that a trademark owner could have goodwill in New York based on foreign use of the mark, the court is recognizing an exception to the territoriality principle that is essentially the well-known marks doctrine.

As to Question No. 2, the court responded that the minimum standard for fame of the foreign mark is that "[a]t the very least, a plaintiff's mark, when used in New York, must call to mind its goodwill. Otherwise, a plaintiff's property right or commercial advantage based on

the goodwill associated with its mark is not appropriated in this state when its unregistered mark is used here. Thus, at a minimum, consumers of the good or service provided under a certain mark by a defendant in New York must primarily associate the mark with the foreign plaintiff."[31] The court noted that whether consumers primarily make that association "is an inquiry that will, of necessity, vary with the facts of each case." Accordingly, the court declined to give an exhaustive list of factors to be analyzed, but noted that "some factors that would be relevant include evidence that the defendant intentionally associated its goods with those of the foreign plaintiff in the minds of the public, such as public statements or advertising stating or implying a connection with the foreign plaintiff; direct evidence, such as consumer surveys, indicating that consumers of defendant's goods or services believe them to be associated with the plaintiff; and evidence of actual overlap between customers of the New York defendant and the foreign plaintiff."[32] Interestingly, the court did not include copying of the plaintiff's trade dress—which occured in the *ITC* case—in its list of examples of evidence that the defendant intentionally associated its goods with those of the foreign plaintiff. One would think such copying was showed an intent to create an association.

In summarizing, the court held that, "to prevail against defendants on an unfair competition theory under New York law, ITC would have to show first, as an independent prerequisite, that defendants appropriated (i.e., deliberately copied) ITC's Bakhara mark or dress for their New York restaurants. If they successfully make this showing, defendants would then have to establish that the relevant consumer market for New York's Bukhara restaurant primarily associates the Bukhara mark or dress with those Bukhara restaurants owned and operated by ITC."[33] Putting this test into the context of the well-known marks doctrine, the court has held that "niche fame" is sufficient and knowledge among the general public is not required.

The case will now go back to the Second Circuit for further proceedings. Presumably it will be remanded to the district court to afford ITC an opportunity to prove its common law unfair competition case, the only potential ground for relief remaining.

However, New York State's recognition of an unfair competition claim for use of a foreign mark that has achieved niche fame in New York still leaves a lot to be desired as far as international trademark owners are concerned. New York, although an important commercial center, is only one of many states. The highest courts of other states could reach different decisions about the applicability of the Famous Marks Doctrine, or similar unfair competition principles, in their states when and if the issue comes before them. International trademark owners need protection that they can rely on to be uniform throughout the United States.

VII. Articles 7 and 8 of the Pan American Convention

If the *ITC* decision is correct, and neither Article *6bis* of the Paris Convention nor Article 16(2) of TRIPS applies in the United States, then the little-known provisions of Articles 7 and 8 of the Pan American Convention will assume far greater importance for trademark owners in the United States and the Latin American countries that are parties to the treaty, namely, Peru, Colombia, Cuba, Guatemala, Haiti, Honduras, Nicaragua, Panama and Paraguay. The protections of the treaty are available not only to nationals of these countries, but also to "domiciled foreigners who own a manufacturing or commercial establishment or an agricultural development in any of the contracting states."[34] In additions, the benefits of Article 7 are available to "[a]ny owner of a mark protected in one of the contracting states." Thus many Latin American trademark owners that are not nationals of a party to the treaty, but have protected their mark in a country that is a party, will be able to invoke the treaty provisions in another country that is a party.

Article 7 of the Pan American Convention provides:

> Any owner of a mark protected in one of the contracting states in accordance with its domestic law, who may know that some other person is using or applying to register or deposit an interfering mark in any other of the contracting states, shall have the right to oppose such use, registration or deposit and shall have the right to employ all legal means, procedure or recourse provided in the country in which such interfering mark is being used or sought, and upon proof that the person who is using such mark or applying to register or deposit it, had knowledge of the existence and continuous use in any of the Contracting States of the mark on which opposition is based upon goods at the same class, the opposer may claim for himself the preferential right to use such mark in the country where the opposition is made or priority to register or deposit in such country, upon compliance with the requirements established by the domestic legislation in such country and by this Convention.

Article 8 states:

> When the owner of a mark seeks the registration or deposit of the mark in a Contracting State other than that of origin of the mark and such registration or deposit is refused because of the previous registration or deposit of an interfering

mark, he shall have the right to apply for and obtain the cancellation or annulment of the interfering mark upon proving, in accordance with the legal procedure of the country in which cancellation is sought, the stipulations in Paragraph (a) and those of either Paragraph (b) or (c) below:

(a) That he enjoyed legal protection for his mark in another of the Contracting States prior to the date of the application for the registration or deposit which he seeks to cancel; and

(b) That the claimant of the interfering mark, the cancellation of which is sought, had knowledge of the use, employment, registration or deposit in any of the Contracting States of the mark for the specific goods to which said interfering mark is applied, prior to the adoption and use thereof or prior to the filing of the application or deposit of the mark which is sought to be cancelled; or

(c) That the owner of the mark who seeks cancellation based on a prior right to the ownership an use of such mark, has traded or trades with or in the country in which cancellation is sought; and that goods designated by his mark have circulated and circulate in said country from a date prior to the filing of the application for registration or deposit for the mark, the cancellation of which is claimed, or prior to the adoption and use of the same.

The protections these Articles grant are, in fact, somewhat broader than, or at least different from, the Famous Marks Doctrine. The availability of protection is based not on the fame of the foreign mark, but on the usurper's knowledge of that mark. Thus, even if the foreign mark is not well known to the public, the foreign owner would be entitled to protection if the usurper knew of the mark. If, for example, Article 7 applied in the Bukhara restaurant case discussed above, the plaintiffs could have prevailed even if they were unable to show that the Bukhara mark for Indian restaurants was well known in the United States, because the defendants admittedly knew of the plaintiffs' foreign use of the mark at the time they adopted it. It is arguable that Articles 7 and 8 leave a gap in famous mark protection because, in theory, they would not apply to a famous mark that the usurper did not happen to know about before he or she adopted it. In practice, however, any such gap is doubtful. As noted below, decisions applying these articles typically rely, at least in part, on a mark's fame within the jurisdiction as circumstantial evidence that the usurper knew of the mark's use outside the jurisdiction.

Further, Articles 7 and 8 are not vulnerable to the reasoning the Second Circuit used to preclude application of Article *6bis* of the Paris Convention in the *ITC* case—that the treaty is not self-executing and Congress has never enacted implementing legislation: The U.S. Supreme Court has expressly held that the Pan American Convention is self-executing and became U.S. law upon ratification without the need for implementing legislation.[35]

Earlier this year, in *Diaz* v. *Servicios de Franquicia Pardo's S.A.C.*,[36] the Trademark Trial and Appeal Board relied on Article 7 in holding that a Peruvian trademark that was neither used nor registered in the U.S. had priority over the same mark used for the same services by a usurper in the U.S. In *Pardo's,* a proceeding to oppose registration, the applicant had been using the mark

for eat-in and take out restaurant services in Peru and owned several Peruvian registrations for the mark. One day after the Peruvian trademark owner applied for a registration in the United States based on the Peruvian registrations and an intent to use the mark in the U.S. pursuant to § 44 of the Lanham Act, the opposer, Diaz, a Peruvian living in Miami, filed his own application for the same mark for the same restaurant services. When the Peruvian owner's application was approved and published, Diaz opposed it on the grounds that he was the senior user of the mark in the United States. Diaz's claim to be the senior user was based on his prior use of the mark in the United States, even though he had no U.S. registration. Under U.S. trademark law, rights in a trademark are acquired by use. Thus, a prior user can have priority even if he or she is not the first to apply for registration. The Peruvian owner asserted Article 7 of the Pan American Convention as an affirmative defense and moved for summary judgment (a procedure available to avoid a trial when there are no disputed issues of fact).

The Board had no difficulty granting summary judgment in favor of the Peruvian owner. It held that, to invoke Article 7 successfully, the Peruvian owner would have to show that there were no genuine factual disputes (1) that it is the owner of a PARDO'S CHICKEN mark protected in Peru; (2) that it "may have" known that Diaz was using or applying to register an interfering mark in the United States; (3) that Diaz had knowledge of the existence and continuous use in Peru of the PARDO'S CHICKEN mark in connection with services in the same

class prior to his use of the PARDO'S CHICKEN mark in the United States, and (4) that the Peruvian owner has complied with the requirements set forth in the domestic legislation in the United States and the requirements of the Pan American Convention. The evidence clearly supported all of these elements.

As to the element of Diaz's knowledge of the Peruvian mark, he attempted to argue that, although he may have known that the mark was used in Peru, he had no knowledge that it was connected in any way to the Peruvian owner and therefore the terms of Article 7 were not satisfied. The Board made short work of this nonsense, holding that he did not have to know the identity of the Peruvian owner; he only had to know that the mark was being used there by someone else. To infer Diaz's knowledge, the board relied on circumstantial evidence, including Diaz's Peruvian origin, that Diaz had lived in Peru for a period of time within twenty blocks of a PARDO'S CHICKEN restaurant, and (most obviously) that he had happened to adopt the same mark in exactly the same style of lettering as the Peruvian owner.

The T.T.A.B. had previously considered Article 8 of the Pan American Convention in *British-American Tobacco Co. v. Phillip Morris Inc.*[37] That case was a proceeding to cancel two U.S. registrations for the mark BELMONT for cigarettes commenced by an owner of several registrations for that mark in countries that are party to the Pan American Convention. Among other grounds, rights under Article 8 of the Convention were asserted. On a motion to dismiss the Article 8 claims, the Board determined that it had jurisdiction to consider Article 8 claims, even though the Pan American Convention is not part of the Lanham Act, the U.S. trademark law under which the Board was created. The Board also determined that Article 8 could be asserted as grounds to cancel a registration more than five years old, even though the Lanham Act expressly limits the grounds on which such a registration may be cancelled and Article 8 is not included.

Peruvian trademark authorities have also applied the Pan American convention to benefit U.S. trademark owners. In July 1999, the Peruvian Trademark Appeal Board (*Tribunal de Defensa de la Competencia y de la Propiedad Intelectual de Indecopi*) upheld an opposition based on Article 7 by the U.S. owner of the mark MORROW for certain garments against a Peruvian application for the same mark for similar goods.[38] In that case, the opposer's U.S. registration was issued after the Peruvian application was filed, but it was based on a first use date before the Peruvian application. The Board held that this was sufficient. The Board also based its finding that the Peruvian applicant knew of the U.S. registrant's use on circumstantial evidence that the mark was known, at least to some extent, in Peru. The evidence showed that magazines containing advertisements for the U.S. registrant's goods had circulated in Peru. The Board held that this was sufficient to show the Peruvian applicant's knowledge, especially when coupled with the identity of the two trademarks.

In a similar situation in January 2001, the Peruvian Trademark Office (*Oficina de Signos Distintivos-OSD*) granted an opposition by the owner of U.S. registrations for the marks NET2PHONE, NET2PHONE PRO, NET2PHONE and globe design, and other similar marks for telecommunications services against a Peruvian citizen's application for the mark NET2PHONE PRO PERU for telecommunications services based on Article 7 of the Pan American Convention. All of the necessary elements for application of Article 7 were substantially indisputable except for the Peruvian applicant's knowledge of the U.S. use of the mark. Again, this was inferred from circumstantial evidence. The evidence demonstrated that the U.S. marks had been publicly displayed and exposed in Peru, primarily through the U.S. registrant's Internet website, and that the telecommunications business in Peru was concentrated and its participants highly knowledgeable about what is happening in the industry. This, together with the use of similar marks and a similar globe design, was enough to support a finding that the Peruvian applicant knew of the U.S. registrant's use of the mark.

VIII. Conclusion

The recent *ITC* case unexpectedly determined that (a) the Famous Marks Doctrine is not a part of the United States's internal trademark law, and (b) Article *6bis* of the Paris Convention and Article 16(2) of TRIPS are inapplicable in the U.S. because they have not been implemented by internal legislation. These holdings, which the Supreme Court has determined not to review, considerably diminish the potential protection in the United States for marks that are known in the United States, but neither used nor registered there. This unexpected turn of events casts a spotlight on the relatively obscure, and heretofore little used Articles 7 and 8 of the Pan American Convention. It is likely that they will assume increased importance in the international protection of trademarks in the Americas for those in a position to take advantage of them, and international practitioners should become familiar with them.

Endnotes

1. 20 March 1883, as revised at Stockholm, 14 July 1967, 21 U.S.T. 1583, 828 U.N.T.S. 305.
2. 108 Stat. 4809 (1994).
3. 46 Stat. 2907.
4. *See, e.g., Buti v. Impressa Perosa, S.R.L.*, 139 F.3d 98, 103 (2d Cir. 1998); *Person's Co. v. Christman*, 900 F.2d 1565, 1568-69 (Fed. Cir. 1990).
5. *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1171-72 (S.D.N.Y. 1984).
6. *Id.* at 1171.

7. *See A. Bourjois & Co. v. Katzel,* 260 U.S. 689 (1923); *American Circuit Breaker Corp. v. Or. Breakers, Inc.,* 406 F.3d 577, 581 (9th Cir. 2005).
8. A version of it is, however, the prevailing principle of international copyright protection. Under the primary international copyright agreements, the Berne Convention and the Universal Copyright Convention, a copyright protected in one country is, in general, also protected in all member countries.
9. The Ninth Circuit is comprised of the states of Alaska, Idaho, Montana, Oregon, Washington, California, Hawaii, Nevada and Arizona, and the territory of Guam.
10. *Grupo Gigante S.A. de C.V. v. Dallo & Co.,* 391 F.3d 1088, 1094 (9th Cir. 2004).
11. 159 Misc. 551, 288 N.Y.S. 29 (Sup. Ct., N.Y. Co. 1936).
12. 20 Misc. 2d 757, 193 N.Y.S.2d 332 (Sup. Ct., N.Y. Co. 1959).
13. The Trademark Trial and Appeal Board is an administrative tribunal within the U.S. Patent and Trademark Office. Its decisions are not binding on the federal courts, but are ordinarily accorded great weight on matters of federal trademark law.
14. *Mother's Restaurants, Inc. v. Mother's Other Kitchen, Inc.,* 218 U.S.P.Q. 1046 (T.T.A.B. 1983); *First Niagara Ins. Brokers, Inc. v. First Niagara Fin. Group, Inc., 77* U.S.P.Q.2d 1334 (T.T.A.B. 2005), *overruled on other grounds,* 476 F.3d 867 (Fed. Cir. 2007).
15. 220 U.S.P.Q. 1069 (T.T.A.B. 1983).
16. The Second Circuit is comprised of the states of New York, Connecticut and Vermont. Under the federal judicial system in the U.S., the decisions of a federal circuit court are binding as precedent only within that circuit. However, decisions of the Second Circuit tend to be widely respected, particularly on matters of trademark and other intellectual property law. When conflicts over interpretations of federal law arise between or among circuit courts, the United States Supreme Court can resolve them and establish a uniform interpretation for the country.
17. *ITC Limited v. Punchgini, Inc.,* 482 F.3d 135 (2d Cir.), *cert. denied,* __ U.S. __, 128 S. Ct. 288, 169 L. Ed. 2d 38 (2007).
18. 482 F.3d at 144.
19. 482 F.3d at 165.
20. *Id.*
21. *See* McCarthy on Trademarks § 9:4 at 29-30.
22. 482 F.3d at 164.
23. 76 U.S.L.W. 3009 (26 June 2007) (No. 06-1722).
24. 482 F.3d at 166.
25. In some, but not all, of the states, where a point of state law is uncertain, it is possible for a federal appellate court to clarify state law by asking the highest court of the state to answer stated questions. This procedure is known as "certification" of the questions. Where "certification" is not available (because state law does not allow it), a federal court must make the best prediction it can of how a state's highest court would rule.
26. 482 F.3d at 166-67.
27. *ITC Limited v. Punchgini, Inc., No. 165,* Slip Op. (N.Y. 13 December 2007) at 1, 13-14.
28. *Id.* at 10.
29. *Id.* at 12-13.
30. *Id.* at 13-14.
31. *Id.* at 14.
32. *Id.* at 15.
33. *Id.*
34. Pan American Convention, Article 1.
35. *Bacardi Corp. of America v. Domenech,* 311 U.S. 150 (1940).
36. Opposition No. 91159871 (T.T.A.B. 16 February 2007), 2007 WL 549241.
37. 55 U.S.P.Q.2d 1585 (T.T.A.B. 2000).
38. Decision No. 912-1999/TPI-INDECOPI.

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ICC Advance on Costs: Strategical Games

By Lisa Bench Nieuwveld

I. Introduction

As international arbitration increases in popularity, so do the strategies parties develop in order to gain some procedural advantage. One such strategy is for the Respondent to simply refuse or fail to pay the advance on costs necessary to enable the arbitration to proceed. Most institutions require some advance deposit to cover the tribunal's fees and expenses for the parties to pay in order to initiate the arbitration. If this advance is not paid, the case typically is dismissed (without prejudice). As Bühler describes it, "arbitration is a 'pay as you go' concept."[1]

Most institutions, such as the International Chamber of Commerce (hereinafter the "ICC"), will dismiss any claim should the parties fail to pay the advance on costs, but allow the paying party to front the entire advance on costs in order to have its case proceed to the arbitral tribunal. In other words, it does not so much matter who pays, but rather that the fees are in fact paid, in order for any claim to reach the tribunal. The paying party then must await the final award: should the foregoing party win the dispute, the tribunal will order the non-paying party to reimburse the paying party. This places a heavier financial burden on the paying party, effectively reducing one of arbitration's attractions that both parties bear the costs (at least until otherwise allocated in the final award). Some parties use this strategy to delay or halt the arbitration by refusing to pay.

This article discusses a possible method the paying party may employ to minimize its costs and still get the merits before the tribunal without having its claims dismissed under the ICC's arbitration rules (referred to below as the "ICC Rules"). First, however, the article will review other arguments which parties have asserted in these circumstances, with mixed results.

II. Traditional Arguments

Two lines of argument have been developed in an effort to force the non-paying party to bear its share of the advance on costs, namely: (1) the breach of contract theory; and (2) the interim measure approach.[2] The following summary is not intended to discuss these theories in depth, but rather to give a general and broad outline as background about past approaches to this situation.

A. Breach of Contract Theory

The breach of contract theory (referred to below as the "Contract Theory") is exactly as the name suggests: The paying party argues that a binding agreement arose between both parties when they chose, in the relevant dispute resolution provision, to submit their dispute to the ICC. This binding agreement results in the parties being contractually bound to comply with the ICC Rules, including Article 30(3). This article requires both parties to pay their (equal) portion of the advance on costs. According to Wenger, arguing the Contract Theory is a right the party can assert when the other fails to pay its portion, because this article creates reciprocal implicit obligations.[3] Failure to pay this advance on costs constitutes a contractual breach.[4]

At first glance, the argument appears quite viable and some tribunals have applied such an argument. However, the problem remains that the paying party must still front the costs of the arbitration in order to get its claim before the tribunal. Once there, the paying party can raise this claim in the hope that the tribunal will order the other party promptly to reimburse the paying party.

Some parties have successfully argued this theory. Secomb discussed a few non-published ICC awards in which the tribunals applied this theory.[5] ICC Partial Award 7289 looked to Article 9(2) of the 1988 ICC Rules, which was virtually equivalent to ICC Rules Article 30(3).[6] That case clearly stated that, even if one party covers the entire advance on costs, "it does not deprive the contractual creditor of its right to force the other party to fulfill its obligations."[7] This suggests that the tribunal followed the Contract Theory.

Other parties have successfully argued that the Contract Theory was inapplicable because a reciprocal obligation between the parties has not arisen. Instead, the argument goes, the parties only made an agreement with the ICC Court of Arbitration (the "Court"), making it a procedural matter.[8] Another arbitrator agreed that it was a procedural matter, but instead looked to Article 30(2) as the basis, which grants the Court the right to fix separate advances on costs should counterclaims exist. His reasoning was that reciprocal obligations must exist between the party and the Court, instead of between the parties themselves. If the Court has the authority to establish separate costs for counterclaims, any commitment to pay costs is between the party and the Court and, as such, is procedural.[9]

This leads to the second approach, an interim measure, to force the non-paying party to front its portion of the advance on costs or refund what the paying party already fronted.

B. Interim Measure Approach

Under this approach, parties request the tribunal to render a provisional measure requiring the non-paying

party to cover its portion of the advance or to refund the paying party. What is critical here, and often the problem, is getting the provisional measure claim to the tribunal before the claim gets dismissed. Paying the advance on costs for both parties would guarantee this, but it may also be prohibitively costly.

Two cases (one in France and one in the United States) involved a party who refused to pay its portion of the advance.[10] Consequently, the ICC dismissed the respective claims. In response, the parties went before the courts of their respective jurisdictions and brought an interim measure claim. Although they were both successful in receiving favorable judgments and forcing the non-paying parties to pay their portion of the advances, this is clearly inefficient with regard to both time and economics. This leads to my recommended approach, namely, the provisional amount approach.

III. Provisional Amount Approach

No approach will find universal success, and even the provisional amount approach requires some cash outlay. However, it allows the paying party to pay less than the total advance on costs and get the merits of the claim before the tribunal. It is specifically designed for arbitral disputes which fall under the auspice of the ICC Rules.

ICC Rules Article 30(1) states, "After receipt of the Request, the Secretary General may request the claimant to pay a provisional advance in an amount intended to cover the costs of arbitration until the Terms of Reference have been drawn up." The claimant can request the Court to determine a smaller, provisional amount for it to pay, in lieu of the full advance on costs. This will ensure that the arbitration proceeds through the terms of reference stage, effectively getting the merits before the tribunal. The claimant can then finally request an interim measure to force the nonpaying party to pay its portion of the advance on costs. The ICC Rules Article 23(1) allows the tribunal to issue a partial award on an interim measure before the terms of reference are drawn up.[11]

Therefore, the claimant has managed to (1) pay less in fees than the total advance on costs, (2) circumvent any procedural issues, (3) get the merits before the arbitral tribunal, and (4) reserve the argument for the final award, should the interim measure petition prove fail.[12]

Although once one reaches the arbitral tribunal the traditional claims for an interim measure or contract theory are optional arguments, most parties fail to recognize that the provisional amount method exists under the ICC Rules. It is the method which allows the merits of the case to get before the tribunal, without the case being dismissed, in order to request that the tribunal make an award or order regarding the advance on costs.

IV. Complication: Counterclaims

Article 30(2) of the ICC Rules clearly states that, when a party submits a counterclaim, the Court may separate the costs. Under Article 30(4), if one party fails to pay its costs for the counterclaim, the Court shall dismiss it. What happens when the paying party pays the provisional amount, as I recommended above? Can the paying party then invoke this article to have the non-paying party's counterclaim dismissed?

As of yet, it is unclear whether the provisional amount approach would also allow the paying party to have the non-paying party's counterclaim(s) dismissed premised on Article 30(2)(4). However, if the paying party is paying even a provisional amount, this is comparable to paying the entire advance on costs. The non-paying party's failure to pay its portion remains the same and, therefore, the idea behind Article 30(2)(4) would likely extend even to a party paying only a provisional amount.

V. Conclusion

Parties can effectively delay arbitration proceedings by using the tactic of refusing to pay the advance on costs. Although a paying party can simply pay the entire advance on costs and proceed with the claim in the hope it can recover the advance in the final award, the provisional amount approach can serve two purposes. First, it makes it possible for the paying party to avoid covering the entire advance on costs and, second, it may invoke a little sympathy with the arbitral tribunal, who may recognize the strategical "game" the non-paying party is playing.

Endnotes

1. Bühler, *Non-payment of the advance on costs by the respondent party—is there really a remedy?* (2005) Special Supplement ICC ICArb. Bull. 290, 294 para.14.
2. *Id. See also* Favre-Bulle, *Les Conséquences du non-paiement de la provision pur frais de l'arbitrage par une partie—un tribunal arbitral peut-il condemner un défendeur au paiement de sa part de l'avance de frais?*, 19:2 ASA Bull. 277 (2001); Rouche, *Le paiement par le défendeur de sa part de provision sur les frais d'arbitrage: simple faculté ou obligation contractuelle?*, 4 Revue de l'arbitrage 841-855 (2002).
3. W. Wenger, Int'l Arb. In Switzerland, (S. Berti e d.), Art. 178, para. 71 (2000).
4. Rouche, *Le paiement par le défendeur de sa part de provision sur les frais d'arbitrage: simple faculté ou obligation contractuelle?*, 4 Revue de l'arbitrage 841 (2002).
5. Secomb, *Awards & Orders Dealing with the Advance on Costs in ICC Arbitration: Theoretical Questions & Practical Problems*, 14:1 ICC ICArb. Bull. 59, 60 (2003).
6. *Id.* at 61, *citing* Partial Award dated 2 September 1996 in ICC case 7289.
7. *Id.*
8. Partial Award No. 2 of 1 June 2004, ICC case 12491, as cited in Bühler, note 1 *supra*.
9. Interim Award of 26 March 2002, 21:4 ASA Bull. 802, 805, para. 15-16, 19.

10. *Fertalage Industries (Algeria) v. Société Kaltenbach Thurin, S.A. (France)*, Tribunal de grande instance, Beauvais, 9 April 1998 (unreported); *Ulrich Schubert v. H.O. Engineering, Inc.*, Docket No. L-4310-90 (N.J. Super. Ct. Middlesex Co. 4 March 1994), both found in W.L. Craig, W. Park & J. Paulsson, INT'L CHAMBER OF COMMERCE ARBITRATION at 269-270 (3d ed. 2000).

11. ICC Rules Article 23(1) states:

> Unless parties have otherwise agreed, as soon as the file has been transmitted to it, the Arbitral Tribunal may, at the request of a party, order any interim or conservatory measure it deems appropriate. The Arbitral Tribunal may make the granting of any such measure subject to appropriate security being furnished by the requesting party. Any such measure shall take the form of an Order, giving reasons, or of an Award, as the Arbitral Tribunal considers appropriate.

12. See ICC Rules Article 33, which creates an automatic waiver for objections not raised when a party proceeds with the arbitration.

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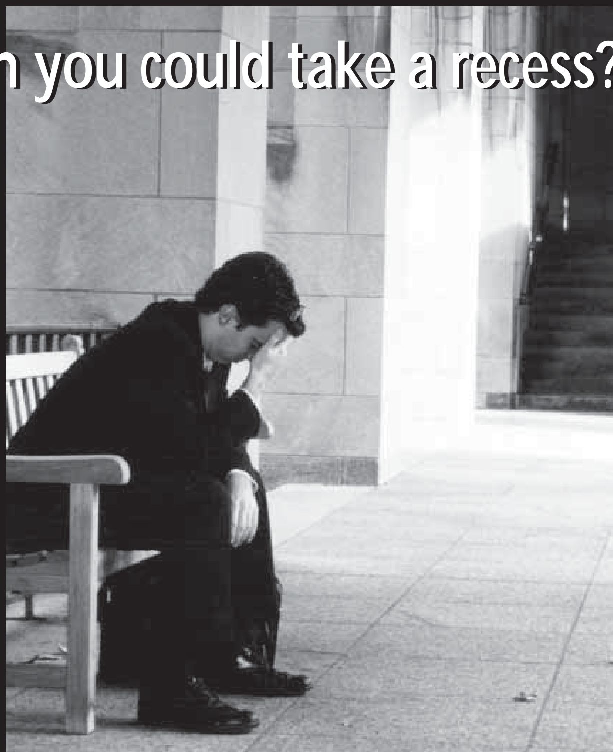

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Distributor Termination in the United States

By Andre R. Jaglom

I. Introduction

There are a variety of considerations applicable to a contemplated termination of a distributor in the United States. These include the provisions of the governing distribution agreement[1] (although there are situations in which those provisions may not be enforced), applicable state law, and some aspects of U.S. federal law, such as federal antitrust (competition) law, the Federal Arbitration Act, and certain statutes governing particular industries, such as the automotive and petroleum industries. This article discusses these laws and the key provisions of distribution agreements that may ameliorate the effect of such laws protecting distributors.

II. Effect on Termination Rights in the Absence of a Written Agreement

In the absence of a written contract setting forth the rights and obligations of the parties to the distribution relationship and, in particular, the circumstances in which the relationship may be terminated and the consequences of such a termination, the parties' relationship will generally be governed by state law. In some states, a statute of frauds may preclude enforcement of an oral agreement entirely.[2] In other jurisdictions, a jury may be permitted to infer an implied contract from conduct where none was intended.[3]

If no written agreement or written provision governing termination exists, the parties will be left to the vagaries of state statutory and case law, which vary widely, on such issues as the supplier's right to terminate, and it becomes important to determine what the parties' rights will be should the supplier decide to terminate the relationship.

A. Common Law Contract Rules

In the absence of an applicable dealer protection law, some courts have held that an order-to-order relationship, with no express or implied agreement as to duration, may be discontinued by the supplier at any time.[4] Courts have also imposed requirements of continuation of the relationship for a reasonable period, reasonable notice of termination, or good cause for termination.[5]

B. Uniform Commercial Code

Section 2-309 of the Uniform Commercial Code, applicable in the great majority of U.S. states, governs the performance and termination of continuing agreements of indefinite duration for the sale of goods. A contract that provides for successive performances but is of indefinite duration is considered valid for a reasonable time, but unless otherwise agreed, it may be terminated at any time by either party.[6] However, unless termination is to occur on the happening of an agreed event, termination of a contract by one party requires reasonable notification.[7] The U.C.C. also imposes a general good faith standard.[8]

C. State Statutes

In some states, a termination may invoke state consumer and businessperson protection statutes.[9] In addition, many states have business franchise laws with very broad scope that restrict the termination of distributors notwithstanding any contractual provisions. Puerto Rico has a very broad dealer protection law governing virtually all distribution relationships. These are discussed further in Part III below.

III. State Franchise Laws

Many states have business franchise laws or other dealer protection statutes that restrict terminations (notwithstanding the terms of an agreement) or impose disclosure or registration requirements.[10] Some of those statutes apply only to written agreements; relying on an oral arrangement may avoid the impact of these laws.[11] If the proposed agreement is with an existing distributor whose relationship predates the applicable statute, one should consider the risk of losing the defense that the statute may not constitutionally apply to a pre-existing agreement. A new written agreement might be deemed a new contract to which the statute could apply, while a continuation of the pre-existing oral agreement might be viewed as outside the scope of the statute.[12]

Case law on this subject varies widely. Some cases have held that the continuation of an at-will or order-to-order relationship after the enactment of a law in effect renews the contract and brings it within the new law, at least if there are material changes to the contract after the date of enforcement.[13] In contrast, one court held that repeated renewal, after enactment of the Illinois Franchise Disclosure Act, of a contract predating its enactment did not bring the agreement within the Act[14] and another decision found no "significant alteration" of a contract sufficient to bring it within a new law where product lines were added to and removed from the relationship.[15] In a similar inconsistency, amendments to New York's beer franchise protection law were applied retroactively, because the parties could anticipate changes in the law affecting the heavily regulated alcoholic beverage industry,[16] while exactly the same contention was rejected in a decision refusing to apply the equivalent Kansas statute retroactively.[17]

A. Generally

1. Breadth of Coverage

It is critical that counsel explore the applicability of any state business franchise law or other dealer protection statute. Some three-quarters of the states have general statutes regulating franchises, business opportunities or both. These are often applicable to a much wider variety of distribution arrangements than classic fast food or muffler type franchises.

2. Types of Statutes

Some of these laws require specified detailed disclosures and sometimes registration with state authorities.[18] (The Federal Trade Commission Rule on franchising, 16 C.F.R. Part 436, is similar.) Some statutes restrict the supplier's right to terminate the relationship or otherwise regulate the substantive nature of the relationship, such as the supplier's right to prohibit transfers or assignments and the supplier's freedom to increase prices without notice.[19]

3. Industry-Specific Laws

In addition to these general laws, many states have laws regulating distributorships in specific industries, such as petroleum products, motor vehicles, farm equipment, alcoholic beverages and office equipment. Petroleum products and automobile dealers are also protected by federal statutes.[20]

B. Applicability

1. "Franchise" Laws

The definitions of a "franchise" under state statutes and the FTC Rule follow a general pattern. First, there is usually a trademark element—either a license to use the franchisor's trademark, service mark, and the like,[21] or substantial association with such a mark[22] or, in some cases, the mere right to sell goods or services using the mark.[23] Second, there is usually a marketing element—either a community of interest between franchisor and franchisee in the marketing of goods or services,[24] or a marketing plan prescribed by the franchisor.[25] And third, there is often—but not always—a franchise fee element.[26]

2. Puerto Rico's Law 75

Notably, Puerto Rico's Law 75, the Dealer's Contracts Act, applies broadly to virtually all distribution relationships where a dealer has "effectively in his charge in Puerto Rico the distribution, agency, concession or representation of a given merchandise or service."[27] Moreover, the Dealer's Contracts Act has been held to apply to protect both distributors not based in Puerto Rico who distribute in Puerto Rico[28] and Puerto Rico-based distributors who distribute elsewhere.[29]

3. "Business Opportunity" Laws

Another set of definitions applies to "business opportunity" laws, generally involving suppliers who (i) provide or help find locations for vending machines, racks or displays; (ii) purchase all products which the purchaser makes using supplies sold by it to the purchaser; (iii) guarantee that the purchaser will derive income exceeding the price paid or the seller will return the purchase price or repurchase any products, equipment or supplies; *or* (iv) will provide, upon payment of some minimum sum, a sales or marketing program which will enable the purchaser to derive income from the business opportunity. Unlike franchises, where the involvement of the franchisor's trademark is usually a necessary element, the business opportunity laws often *exempt* sales of business opportunities in conjunction with the licensing of a registered trademark.[30]

4. Exemptions

Various state statutes have a variety of exceptions for fractional franchises, suppliers with large net worth, and other situations too varied to explore here. The statutes, regulations and interpretive guides of relevant states should always be consulted.

C. Substantive Restrictions

Many state franchise laws regulate certain substantive provisions of the relationship between franchisor and franchisee, particularly with respect to termination. Such restrictions have generally withstood constitutional attacks, although one court has held such restrictions in a farm equipment dealer protection law violative of a state constitution's due process clause.[31] (That decision was subsequently reversed by constitutional amendment.[32])

1. Termination and Non-Renewal

Of the states with franchise laws restricting termination rights, some, such as Mississippi, merely require that a specified minimum notice be given.[33] Most, however, in addition to requiring minimum notice and opportunity to cure, also require that "good cause" or "just cause" exist, not only for termination but also for non-renewal of a franchise. The statutory definition, if any, of such cause is often very narrow and generally does not include poor sales performance *per se*.[34] A number of definitions do define good cause to include the franchisee's failure to comply with reasonable requirements of the franchise agreement, and performance standards might qualify as such a requirement.

Thus, Puerto Rico prohibits termination or non-renewal of a dealer's contract without "just cause," regardless of any contract provision permitting termination,[35] and limits just cause to "[n]onperformance of the essential obligations of the dealer's contract or any action or omission that adversely and substantially affects the interests of the principal . . . in promoting the marketing or distribution of the merchandise or service."

The penalties for wrongful termination can be severe. In Puerto Rico (where the dealer protection law is especially broad and covers virtually all distribution arrangements), the distributor can recover damages for everything it spent on the business that it cannot use for another purpose, the cost of its inventory, goodwill, plus, on top of all that, five years of profits.

Moreover, many states require that, before termination occurs, the franchisee or distributor be given a specified period of time—often sixty or ninety days—in which to cure any deficiency.[36] "Curing" has been held not necessarily to require correction of a breach, but merely the taking of steps to avoid a recurrence. Thus a distributor who made out-of-territory sales in breach of a contractual provision was held to have cured the deficiency by ensuring that such sales did not recur.[37]

2. Addition of Distributors

Some state laws not only restrict termination and non-renewal but other diminutions of a franchise, such as the addition of other distributors or franchisor-owned outlets in the franchisee's area.[38]

3. Other Substantive Restrictions

Some state laws also restrict other aspects of the franchise relationship, such as barring or limiting restrictions on franchisee associations, restrictions on changes in management or ownership, requirements that goods or services be obtained from the franchisor, discrimination among franchisees in price, credit terms, services and the like, unreasonable performance standards, or increases in prices without notice.[39]

4. Waiver of Rights

Many statutes prohibit any waiver by the franchisee of its statutory rights.[40] This would include a waiver by virtue of a contractual choice of law provision selecting the law of another jurisdiction to govern the contract. See discussion in Part VII.G. below as to how courts have treated such provisions under such statutes.

IV. Antitrust Laws

In general, U.S. antitrust laws, in the absence of monopoly power, are concerned with concerted action, not unilateral conduct. Moreover, concerted action among competitors—"horizontal" conduct—is generally considered *per se* unlawful, meaning that economic or other justifications will not be heard. Until this year, the same was true for vertical agreements—that is, agreements between buyer and seller—that set a minimum resale price for the affected product. The Supreme Court overturned that rule in 2007 in the landmark decision, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[41] Now all vertical agreements, whether related to pricing or to non-price matters such as territories restrictions, are judged by the "rule of reason," under which the court must determine whether the anticompetitive harm from the conduct is outweighed by potential competitive benefits.[42] The proof required of a plaintiff in a rule of reason case is generally much greater, as are the costs of litigation.

The principal danger for suppliers terminating distributors thus lies in the area of *per se* violations. Accordingly, suppliers should avoid circumstances in which they terminate a distributor in response to the request of a number of that distributor's competitors. In those circumstances the claim might be asserted that the supplier was acting as a member of a horizontal conspiracy of the competing dealers.[43]

In general however, the antitrust laws are designed to protect competition, not individual competitors, and in the absence of concerted action, a supplier's decision to replace one distributor with another does not implicate the antitrust laws.[44]

V. Good Faith and Fair Dealing

In most states, every contract is deemed to contain an implied covenant of good faith and fair dealing.[45] In general, this implied covenant will not be applied to contravene an express contractual provision, such as a contractual right to terminate without cause.[46] This rule is not universal, however, and courts have applied the implied covenant of good faith and fair dealing to invalidate terminations that were particularly egregious or unfair.[47]

Moreover, such terminations that are performed in an unconscionable or unfair manner may be actionable as well. For example, the United States Court of Appeals for the Fourth Circuit has held that, under South Carolina law, even where a contract provides a broad right to terminate without cause, such a termination is actionable "if the manner of termination is contrary to equity and good conscience," as where it is unconscionable or causes needless injury.[48] In contrast, where clear notice was given of the reasons for termination and the steps needed to be taken by the dealer to cure its defaults, the manner of termination was proper and the termination upheld.[49]

Similar concerns militate against the pre-termination gathering of customer and sales data or inappropriate customer contacts, which could lead to a claim of misappropriation of trade secrets, unfair competition or defamation.

VI. Other Legal Theories

A. Recoupment

A number of states apply the doctrine of recoupment to prohibit termination of a contract of indefinite duration until the distributor has been given a reasonable period of time to recoup its investment in the distributorship.[50] This suggests that suppliers may want to include a representation by the distributor that it already had all the resources necessary to perform the agreement, or an acknowledgment that termination is permitted at any time and that

any "investment" is made voluntarily by the distributor with that understanding.

B. Other Theories

It is worth noting that under some circumstances, a terminating supplier may find itself liable for a business tort or tortious interference with contract or with prospective economic advantage.[51] In addition, some courts have invoked the doctrines of fraud, breach of fiduciary duty or unconscionability in the termination context.[52] Moreover, some courts have held written contractual provisions to be superseded by oral representations.[53]

VII. Key Contract Provisions

Prospects for a successful dealer termination can be considerably enhanced by a carefully drafted distribution contract. While a full discussion of the provisions of such an agreement is beyond the scope of this article,[54] the following provisions are most important.

A. Definition of Dealer Responsibilities

The contract should set forth, in as much detail as possible, what is expected of the distributor. Required levels of inventory; customer call frequencies; sales force size and training; promotion and advertising spending levels; reporting requirements; and restrictions on distribution of competing products; are all areas ripe for contractual definition.

B. Performance Standards

Perhaps most important, clear quantitative performance standards should be set forth, and the failure to achieve them should be specified as a ground for termination. These performance criteria should be appropriate to the product, industry and territory. Volume levels can be stated in dollar terms, unit terms, as a percentage of average regional or national performance, in terms of market share, or on some other basis. Sales figures are generally better for the supplier and worse for the distributor than purchase requirements; the latter, if they force a dealer to buy more product than it can sell, might bring a supplier under a franchise statute that otherwise might not apply; moreover, standards based on purchases rather than sales allow the dealer to avoid—or least delay—termination by buying excess inventory without genuinely building a larger market for the product. New account openings and ongoing distribution levels, in terms of raw numbers of customers or percentages of potential customers sold, may be appropriate.

Distributors will wish to make clear that termination is the only remedy for failing to meet the standard and that there is no liability for damages as a result of any shortfall. Similarly, the supplier may wish to provide for a right to terminate if the parties cannot agree on new minimum standards for a renewal term, while distributors should resist such a provision. Courts may examine the reasonableness of performance standards.[55] The supplier, in setting the standards, thus should be prepared to exercise the right to terminate consistently among those who do not meet the standard.[56] An alternative is to provide for the right to add additional distributors (i.e., to terminate the distributor's exclusivity) if performance levels are not reached.[57]

C. Duration

The contract may be for a specified term, or indefinite until terminated. Note that some state franchise laws place stricter limits on termination during the contract term than on nonrenewal after expiration.[58] If a specific duration is provided for, consider whether renewal is to be automatic if no notice is given, whether it requires a notice of renewal or the execution of a new agreement. The decision will depend in part on the existence of a systematic procedure for the client to assure that notice will be given. A distributor may want the guaranteed right to renew if certain performance standards are met.

In many states, a contract with no specified duration is terminable at will, on reasonable notice, but if the contract provides for termination upon the occurrence of specified events, it is not of indefinite duration and may not be terminated except when such events occur.[59] Other states disfavor perpetual agreements, at least in the absence of a specifically stated intent. Thus, a contract with defined terms, but subject to automatic renewal, was held to be for fixed terms renewable only if both parties consented, in the absence of an unequivocal statement of an intent to create a perpetual agreement.[60]

In one case under Puerto Rico's restrictive Dealer Contract Act, a distributor's failure to give written notice of renewal as required by contract was held good cause for non-renewal.[61] The court stressed that the non-renewal there was occasioned by the ***distributor's*** non-renewal, not the supplier's. This suggests the inclusion of such a renewal requirement, although if the requirement is ignored for years and then suddenly enforced, the courts are likely to be unsympathetic to the supplier.

D. Grounds for Termination

The contract should specify the basis on which the agreement may be terminated. State laws may restrict these grounds.[62] If there is to be a right to terminate without cause, it should be explicitly stated, bearing in mind that applicable franchise laws may invalidate such a provision. Other grounds for termination will include breaches of contract, or at least material breaches, which may be subject to a specified notice and right to cure.

Note that state franchise laws may require minimum notice and an opportunity to cure. It may be prudent to provide for what will be considered a cure of such deficiencies as a failure to meet performance standards or the

making of prohibited out-of-territory sales, and to stipulate that certain breaches are agreed to be noncurable.

Other grounds (the enforceability of which will again be affected by applicable state law) include changes in ownership, management or control; and financial problems.[63] The supplier may provide that a change in ownership, management, or control of the distributor justifies termination. Some conditions might be included. For example, termination might be permitted upon a transfer of some percentage of the ownership of one or the other party or upon the replacement of specified officers.

The supplier may desire the right to terminate in a variety of other circumstances. For example, if the distributor acts so as to injure the business reputation of the supplier or the products, or if there is a violation of law in connection with the business, termination may be warranted. The supplier may also want the right to terminate if it decides to withdraw from the product or geographic market or to convert to a direct or other distribution channel. State laws may restrict termination in these circumstances.[64]

E. Arbitration

Wholly apart from its general benefits and common usage in international commercial disputes, arbitration has the additional benefit for suppliers of offering a way to enhance the ability to avoid the restrictions of franchise and other dealer protection laws. Contractual arbitration provisions, including their choice of law and forum, will generally be enforced pursuant to the Federal Arbitration Act, even in the face of state law to the contrary.[65] Note, however, that where state law requires a disclosure that a choice of law or choice of forum provision may not be enforceable in that state, a question arises as to whether the parties really agreed to the contractual choice. The Ninth Circuit has held in such circumstances that a contractual choice of forum for arbitration was unenforceable in light of such a mandated disclaimer, finding that the franchisee had no reasonable expectation that it had agreed to an out-of-state forum.[66]

Puerto Rico amended its Dealer's Contracts Act in 2000 (i) to provide that no arbitration clause can be invoked without a determination by a court with jurisdiction in Puerto Rico that the clause was "subscribed freely and voluntarily by both parties" and (ii) to create a "controvertible presumption that any arbitration clause contained in a distribution contract was included at the request of the principal and is an adhesion contract."[67] Although no case has expressly addressed this amendment, several cases decided after the amendment was effective have held that the Federal Arbitration Act preempts the Dealer's Contracts Act and ordered arbitration.[68] While an arbitration agreement may be set aside in the same manner as any contract—for example for "well-supported claims that the agreement to arbitrate results from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract"[69]—the amendment of the Dealer's Contracts Act, which imposes special burdens on arbitration clauses, seems clearly contrary to the principles of the FAA.

As noted above, courts generally will also enforce a provision for a particular arbitration forum.[70] Such a provision for a "home-town" forum may be of benefit to a supplier, as it may impose significant cost on a distributor forced to contest a termination. Another alternative is to provide that the arbitration is held in the home city of the party *not* commencing the proceeding.

F. Choice of Forum

Outside the context of an arbitration clause, contractual provisions for all litigation arising under the agreement or its termination to be brought in a particular court waiving the right to seek a transfer are sometimes enforced and sometimes not.[71] The Supreme Court, in *Burger King Corp. v. Rudzewicz*,[72] enforced a contractual choice-of-forum clause requiring a Michigan franchisee to litigate Burger King's action for breach of contract in Florida, Burger King's home state. *Burger King* merely holds that a franchisor can constitutionally enforce a forum-selection clause against its franchisees in an action commenced by the franchisor.

The supplier also should make certain that the requirements of state long arm statutes and state constitutional due process requirements are met. It is possible that courts in the distributor's home state will refuse to enforce a forum-selection clause on the ground that the public-policy interests of the distributor's state outweigh the parties' choice.[73] Note also that state franchise laws may expressly prohibit the choice of another state as a forum.[74] Federal courts, however, will apply federal law to determine whether to enforce such a clause, notwithstanding any such state view; the forum clause is not dispositive, but should be considered together with the other private and public interest factors normally weighed in a transfer motion pursuant to 28 U.S.C. § 1404(a),[75] at least where the choice is between two federal districts.

A showing of state policy sufficient to outweigh a forum clause may be difficult to make. The Supreme Court has held enforceable a fine print forum selection clause printed on the back of a cruise line's passenger ticket, requiring a Washington resident to sue in Florida for injuries sustained on a cruise off Mexico.[76] The Maryland courts have similarly held that a forum selection clause favoring the franchisor's home state was enforceable despite being incorporated into a form contract where the franchisor had superior bargaining power, reasoning that there was no fraud involved.[77] Similarly, the Sixth Circuit has enforced a choice of law and choice of forum clause contained in a contract allegedly signed in reliance on the defendant's fraud.[78] And the Western District of New

York upheld a one-sided forum clause that restricted venue in actions by a franchisee, but not in actions by the franchisor.[79] The District of New Jersey has recently relied on federal law in granting a motion to transfer to the forum identified in the parties' forum selection clause.[80]

On the other hand, the District of Puerto Rico declined to transfer a dispute to California courts as called for by a contractual forum clause, since it was unchallenged that Puerto Rico was more convenient for witnesses, and there was no evidence justifying transfer other than the contract clause.[81]

In drafting forum selection clauses, counsel should make clear both that jurisdiction in the chosen forum is consented to and that venue in that forum is mandatory.[82] Arbitration clauses calling for a particular forum are highly likely to be enforced. The Seventh Circuit reversed a district court opinion and ordered arbitration in Poland pursuant to a contract in a case under the Illinois Beer Industry Fair Dealing Act, holding that while the state's public policy expressed in that statute required Illinois law to apply notwithstanding the contract's choice of Polish law, that public policy could not overcome the federal policy in favor of arbitration embodied in the Federal Arbitration Act.[83]

G. Choice of Law

A distribution contract should include a choice of law provision. Suppliers may wish to select the law of a jurisdiction that does not have a franchise or dealer protection law, in an effort to avoid the impact of such law on their termination rights and other aspects of the dealer relationship. Such an effort may succeed, if the jurisdiction chosen bears a reasonable relationship to the transaction, e.g., the supplier's home state. While a number of courts have disregarded such choice of law provisions in deference to the public policy of states with franchise laws,[84] or because the validity of the contract containing the clause was questioned,[85] some courts in recent years have honored the parties' choice, at least in the absence of oppressive use of superior bargaining position, although the overall trend has been mixed.[86]

The Michigan courts have found that a Florida choice of law provision in a contract between a Florida franchisor and Michigan franchisee was unenforceable because the choice of law provision significantly eroded the franchisee's protection under the Michigan Franchise Investment Law.[87] Moreover, at least one court, the United States Court of Appeals for the First Circuit, has not only held that Maine's public policy expressed in its wine franchise law voided a contractual choice of law provision, but went so far as to award sanctions against the supplier and its counsel for what it termed a "frivolous" appeal.[88]

The United States Court of Appeals for the Eighth Circuit has held both ways, suggesting at one point that the determining factor may be whether the federal court faced with the question is being asked to apply the law of the forum state or of another forum.[89] This suggests that a race to the courthouse in the preferred forum may be worth the exercise.

The chosen law should have some relationship to the parties or the performance of the contract. A federal district court in New York has held invalid a choice of law provision that bore no reasonable relation to the parties or contract, applying New York law instead.[90] In selecting a particular state's law, note that this may result in the application of either a more or less restrictive state franchise law than might otherwise be the case.[91] Counsel for suppliers should consider seeking to carve such statutes out of the choice of law selection.

Note the importance of drafting a broadly applicable clause governing the rights of the parties, and not merely governing the agreement.[92] Note also that unless the parties provide otherwise, the United Nations Convention on Contracts for the International Sales of Goods[93] will govern contracts for sales of goods between parties who have their places of business in different Contracting States.[94] Significant differences from the terms which U.S.-based parties might expect include the inapplicability of a Statute of Frauds requirement of a signed writing,[95] unless the parties so require by contract,[96] the rejection of the parol evidence rule,[97] "battle of the forms" issues,[98] and the payment of the prevailing party's attorneys' fees.[99]

As noted above, combining a choice of favorable law with an arbitration clause will enhance the likelihood of the choice of law being honored. The strong federal policy in favor of arbitration, embodied in the Federal Arbitration Act,[100] generally has been held to support the parties' choice of law to be applied in arbitration, even in the face of explicit state law to the contrary.[101]

H. Liquidated Damages

A provision stipulating the damages to be paid in the event of a wrongful termination may provide a degree of certainty to a supplier. The enforceability of such provisions varies by state, but typically requires that actual damages be uncertain and difficult to determine, and that the stipulated amount bear a reasonable relationship to actual damages.[102]

VIII. Preparation for a Termination

Proper preparation is critical in planning a termination. The first step is to gather all relevant facts. A checklist should be developed for each business and industry individually, to capture all relevant information. It is important to bear in mind that the weakest link is often at the lowest level of contact between supplier and distributor, and all personnel having such contacts should be interviewed.

Sales personnel should be advised not to gather confidential and proprietary customer and sales information belonging to the distributor in advance of termination unless the supplier is entitled to such data by contract. Similarly, there should be no disparagement of the distributor in the trade or efforts to switch customers to a new distributor in advance of the termination. Conduct that a court would perceive as unfair or in bad faith is to be avoided.

At bottom, however, the best resolution is a business solution. An appropriate payment to the terminated distributor to facilitate the transition and avoid litigation may be a win-win solution, and often such a payment will be willingly paid or shared by the new distributor, who reaps the benefits of the prospective distributorship. Indeed, in some industries, such payments are the norm, and terminations are often effected by having the new distributor purchase the distribution rights from the old distributor at an agreed price. Such transactions are commonplace in the beer industry in the U.S., for example.

IX. Conclusion

Terminations of distributors in the United States may be affected by a variety of laws and circumstances. The risks of termination can be substantially reduced by proper preparation. This begins with careful selection of distributors, recognizing that termination may be difficult, and a well thought out distribution agreement. The agreement should be tailored both to the needs of the parties and to the applicable legal framework, which can vary from state to state and industry to industry. Proper implementation of a proposed termination is equally critical, so as to avoid legal pitfalls arising from the U.S. antitrust laws, state franchise laws and other applicable legal doctrines.

Principles of fairness and equity play a significant role in court decisions, and terminations—and indeed the distribution relationship—should be handled in ways that will be perceived as fair and reasonable, particularly where a large supplier is dealing with a smaller distributor in a relationship that might be viewed as the result of unequal bargaining power.

Endnotes

1. A full discussion of the appropriate provisions of a distribution agreement is beyond the scope of this article. Those interested may download from www.thshlaw.com/AttorneyBios.aspx?A=28 Mr. Jaglom's outline on distribution contracts, which has been published in connection with the American Law Institute-American Bar Association Course of Annual Study on Product Distribution and Marketing (the "ALI-ABA Distribution Program"), chaired by Mr. Jaglom. For a brief discussion of key provisions, see Part VII below.
2. *See, e.g., D & N Boening, Inc. v. Kirsch Beverage, Inc.*, 99 A.2d 522, 471 N.Y.S.2d 299 (2d Dep't), *aff'd*, 63 N.Y.2d 449, 483 N.Y.S.2d 164 (1984). S*ee also Abrams v. Unity Mutual Life Ins. Co.*, 237 F.3d 862 (7th Cir. 2001) (applying New York law, denied an agent's claim of unjust enrichment based on the agent's services to the insurer in reliance on an oral promise and an unsigned agreement; the agent's unjust enrichment claim was an improper effort to circumvent the statute of frauds because it was based on the same promise and sought the same relief as an otherwise barred contract claim; had the agent presented a basis for valuing his services independent of the unenforceable contract, summary judgment might have been denied).
3. *See, e.g., Famous Brands, Inc. v. David Sherman Corp.*, 814 F.2d 517 (8th Cir. 1987).
4. *See, e.g., Smoky Mountains Beverage Co. v. Anheuser-Busch, Inc.*, 182 F. Supp. 326, 331-33 (E.D. Tenn. 1960) (under Tennessee law, the evidence did not show an express or implied contract, and the relationship was terminable at will, with or without cause); *Scanlan v. Anheuser-Busch, Inc.*, 388 F.2d 918, 920 (9th Cir. 1963) (under New Mexico law, the arrangement was held to amount to a contract terminable at will without cause); *Kraftco Corp. v. Kolbus*, 1 Ill. App. 2d 635, 274 N.E.2d 153 (1971) (a distributorship contract with no termination provision was terminable at will without notice).
5. *See, e.g., Sofa Gallery, Inc. v. Stratford Co.*, 872 F.2d 259 (8th Cir. 1989) (contract of no definite duration terminable on reasonable notice sufficient to allow distributor to recoup investment); *Copy-Data Systems v. Toshiba America*, 755 F.2d 293 (2d Cir.), *cert. denied*, 474 U.S. 825 (1985) (oral distribution agreement terminable only after reasonable duration and upon reasonable notice); *Ag-Chem Equip. Co., Inc. v. Hahn, Inc.*, 480 F.2d 482, 487 (8th Cir. 1973) (under Minnesota Law, "as is generally true elsewhere," a contract of indefinite duration is terminable at will upon reasonable notice); *Italian & French Wine Co. of Buffalo, Inc. v. Negociants U.S.A., Inc.*, 842 F. Supp. 693 (W.D.N.Y. 1993) (under New York law, contract with no express termination date implies that performance is to continue for reasonable time and may be terminated only upon reasonable notice); *Des Moines Blue Ribbon Distribs., Inc. v. Drewrys Ltd.*, 256 Iowa 899, 129 N.W.2d 731 (1964) (required contract to continue for a reasonable time, with reasonable notice of termination); *Utility Appliance Corp. v. Kuhns*, 393 Pa. 414, 143 A.2d 35 (1958) (when the duration of a franchise agreement is not fixed, the agreement is effective for a reasonable time and thereafter is terminable at will upon proper notice).
6. Uniform Commercial Code § 2-309(2).
7. *Id.* § 2-309(3).
8. *Id.* § 1-203.
9. *See, e.g.*, Mass. Gen. Laws Ann. ch. 93A (West 1984 & 1986 Supp.). *See generally* Stadfeld, *Survey of State Little FTC Acts and Consumer Protection Statutes*, ABA Forum Committee on Franchising Fourth Ann. Forum (15-16 Oct. 1981).
10. Again, interested readers may download from www.thshlaw.com/AttorneyBios.aspx?A=28 the author's article, "The Broad Scope of Franchise Laws: Traps for the Distribution Contract Drafter," also published in connection with the ALI-ABA Distribution Program.
11. *See, e.g.*, Miss. Code Ann. § 75-24-51; Neb. Rev. Stat. § 87-402; N.J. Stat. Ann. § 56-10-1 (West Supp. 1986); Va. Code § 13.1-559.
12. *See, e.g., Equipment Mfrs Institute v. Janklow*, 2002 U.S. App. LEXIS 15769, Bus. Fran. Guide (CCH) ¶ 12,381, (8th Cir. 2002) (restrictions on termination of farm equipment dealerships were unconstitutional impairment of contracts predating enactment of restrictions); *Cloverdale Equipment Co. v. Manitowac Engineering* Co., Bus. Fran. Guide (CCH) ¶ 11,468, (6th Cir. 1998) (not for publication) (retroactive application of good cause requirement for termination would constitute unconstitutional impairment of contract); *Holiday Inns Franchising, Inc. v. Branstad*, 29 F.3d 383 (8th Cir.), *cert. denied*, 513 U.S. 1032, 115 S. Ct. 613 (1994) (retroactive application of franchise law unconstitutional; plaintiffs did not have notice of reasonable possibility of retroactive regulation) (affirming *McDonald's Corp. v. Nelson*, 822 F. Supp. 597 (S.D. Iowa 1993) (retroactive application of franchise law unconstitutional; legislative purpose of adjusting balance of power between parties

not a sufficient broad societal interest to justify impairment of existing contracts); *Gulfside Distributors, Inc. v. Becco, Ltd.*, 985 F.2d 513 (11th Cir. 1993); *O.R.S. Distilling Co. v. Brown-Forman Corp.*, 972 F.2d 924 (8th Cir. 1992); *Rolec, Inc. v. Finlay Hydroscreen USA, Inc.*, 917 F. Supp. 67 (D. Me. 1996); *Louis Glunz Beer, Inc. v. Martlet Importing Co., Inc.*, 864 F. Supp. 810 (N.D. Ill. 1994) (change from master distributor status to normal distributor, and from subdistributor to distributor, materially altered contract, bringing it within dealer protection statute); *Larco Distributing, Inc. v. Latrobe Brewing Co.*, Bus. Fran. Guide (CCH) ¶ 9774, 1990 WL 168702 (D. Kan. 1990); *Sound Move Autoplaza, Inc. v. Nissan Motor Co., Ltd.*, Bus. Fran. Guide (CCH) ¶ 9399, 1989 WL 50797 (E.D.N.Y. 1989); *Heublein, Inc. v. Dep't of Alcoholic Beverage Control*, 237 Va. 192, 376 S.E.2d 77 (Va. Sup. Ct. 1989); *Rudolph Rosa v. Latrobe Brewing Co.*, 347 Pa. Super. 551, 500 A.2d 1194, 1199-1200 (Pa. Super. 1985). *But see Garal Wholesalers, Ltd. v. Miller Brewing Co.*, 193 Misc. 2d 630, 752 N.Y.S. 2d 679 (Sup. Ct., N.Y. Co. 2002) (retroactive application of beer franchise law's termination restrictions was constitutional because supported by public purpose and a reasonable accommodation between public interest and contractual expectations). *See generally* M. O'Hara, *Retroactive Application of State Franchise Termination Laws*, FRANCHISING L.J., Winter 1988, at 3.

13. *See, e.g.*, Va. Code, Tit. 4, § 4-118.58 (1989). *See also Mays v. Massey-Ferguson, Inc.,* 1990 U.S. Dist. LEXIS 10245, 1990 WL 80673, 1990-1 TRADE CAS. (CCH) ¶ 69,028, BUS. FRAN. GUIDE (CCH) ¶ 9617 (S.D. Ga. 1990) ("significant, as opposed to minor, changes in the contractual relationship between the parties constitutes a renewal" bringing contract within new law). *Cf. David Golper Co., Inc. v. Cargill, Inc.*, 1995 WL 366481, BUS. FRANCH. GUIDE (CCH) ¶ 10,715 (Wis. Ct. App. 1995) (not for publication) (incorporation of distributor after effective date of Wisconsin Fair Dealership Law was implied new agreement making statute potentially applicable).

14. *Jake Flowers, Inc. v. Kaiser*, 2002 WL 31906688, BUS. FRAN. GUIDE (CCH) ¶12,478 (N. D. Ill. 2002).

15. *O.R.S. Distilling Co. v. Brown-Forman Corp.*, 972 F.2d 924 (8th Cir. 1992) (addition and deletion of product lines was not renewal or amendment of oral agreement predating franchise law, so franchise law does not apply).

16. *Garal Wholesalers, Ltd. v. Miller Brewing Co.*, 193 Misc. 2d 630, 752 N.Y.S.2d 679 (Sup. Ct., N.Y. Co. 2002).

17. *Larco Distribution, Inc. v. Latrobe Brewing Co.*, 1990 WL 168702 (D. Kan. 1990).

18. *E.g.*, Calif. Corporations Code § 31000 *et seq.*; N.Y. Gen. Bus. Law § 680 *et. seq.*

19. *E.g.*, Calif. Bus. and Professions Code § 20000 *et seq.*; N.J. Rev. Stats. § 56:10-1 *et seq.*

20. 15 U.S.C. § 1221 *et seq.* (automobile dealers); 5 U.S.C. §§ 2801 *et seq.* (motor fuel).

21. *See, e.g.*, Hawaii Rev. Stat. tit. 26, § 482E-2.

22. *See, e.g.*, Calif. Corporations Code § 31005(a)(2).

23. *See, e.g.*, Mich. Comp. Laws § 445.1502(3)(b).

24. *See, e.g.*, Minn. Stat. § 80C.01(4). An ordinary buyer-seller relationship, if of a continuing nature, may satisfy the "community of interest" requirement.

25. *See, e.g.*, Calif. Corporations Code § 31005(a)(1).

26. *See, e.g.*, California Bus. & Prof. Code § 20001; Haw. Rev. Stat., tit. 26, § 482E-2.

27. 10 Laws of P.R. § 278.

28. *See, e.g., A.M. Capen's Co., Inc. v. American Trading Corp.*, 74 F.3d 317 (1st Cir. 1996) (Puerto Rico Dealer's Contracts Act applies to distributor with exclusive right to distribute supplier's product in Puerto Rico, even though neither supplier nor distributor was located in Puerto Rico, and contract was negotiated and executed in continental U.S.).

29. *Beatty Caribbean, Inc. v. Viskage Sales Corp.,* 241 F. Supp. 2d 123 (D.P.R. 2003). (Dealer's Contracts Act applies to termination of distribution rights in Dominican Republic, where the distributor was based in Puerto Rico and performed much of its distribution activities there.)

30. *See, e.g.,* California Civil Code § 1812.201; Florida Statutes, 1981, § 559.801.

31. *Mays v. Massey-Ferguson, Inc.,* 1990 U.S. Dist. LEXIS 10245, 1990 WL 80673, 1990-1 TRADE CAS. (CCH) ¶ 69,028, BUS. FRAN. GUIDE (CCH) ¶ 9617 (S.D. Ga. 1990) (holding restrictions on termination and other provisions of farm equipment dealer law violate Georgia due process clause by restricting freedom of contract in industry not affected with public interest) (overruled by constitutional amendment).

32. Ga. Laws of 1992, Resolution Act 125, approved 6 May 1992, ratified 3 November 1992.

33. *See, e.g.,* Miss. Code §§ 75-24-51 to 75-24-61.

34. *See, e.g.,* Minn. Stat. § 80C.14(b).

35. 10 Laws of P.R. § 278a.

36. *See, e.g.,* Minn. Stat. § 80C.14(3); 47 Pa. Stat. § 4-492 (19).

37. *McKeesport Beer Distributors, Inc. v. All Brand Importers, Inc.*, 390 Pa. Super. 627, 569 A.2d 951 (Pa. Super. 1990).

38. *See, e.g.,* Hawaii Rev. Stat. § 482E-6(2)(E); Ind. Code, Tit. 23, art. 2, Ch.2.7, § 1(2).

39. *See, e.g.,* 1981 Rev. Code of Wash. § 19.100.180; N.J. Rev. Stat. § 56:10-7; Rev. Stat. Neb. § 87-406; Ind. Code, Tit. 23, art. 2, Ch. 2.7, § 1(2).

40. *See, e.g.,* Mich. Comp. Laws § 445.1527(d); Wis. Stat., Tit. XIV-A, § 135.025(3).

41. __ U.S.__, 2007 WL 1835892 (2007). It remains to be seen how lower courts will interpret *Leegin*, because the Supreme Court took pains to observe that there were circumstances in which resale price arrangements would be found to be anticompetitive and unlawful.

42. *See generally Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

43. *E.g., Lovett v. General Motors Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 9860 (D. Minn. 1991). *See also Denny's Marina v. Renfro Productions, Inc.*, 8 F.3d 1217 (7th Cir. 1993) (boat show's exclusion of marina in response to complaints by marina's competitors of price-cutting was horizontal price-fixing conspiracy and so a *per se* violation); *Malley-Duff v. Crown Life*, 734 F.2d 133 (3d Cir. 1984) (termination of insurance agent was horizontal group boycott, and so per se, where insurance carrier officer who made termination decision was behind-the-scenes principal in new agency that took over the territory, so termination decision was horizontal decision of competitor, not independent vertical decision of carrier).

44. *E.g., Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors Ltd.*, 416 F.2d 71 (9th Cir. 1969), *cert. denied,* 396 U.S. 1062 (1970).

45. *E.g., Carlo C. Gelardi Corp. v. Miller Brewing Co.*, 502 F. Supp. 637 (D.N.J. 1980) (under New Jersey law, an implied covenant of good faith and fair dealing is present in every contract), *aff'd*, Nos. 82-5616, 82-5127, and 82-5218 (3d Cir. 1983); *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917); *A. Brod, Inc. v. WorldWide Dreams, L.L.C.*, 4 Misc. 2d 1006(A), 2004 N.Y. Slip Op. 50733(U) (Sup. Ct. N.Y. Co. 2004).

46. *See, e.g., Devery Implement Co. v. J.I. Case Co.*, 944 F.2d 724, 728-29 (10th Cir. 1991); *Burger King Corp v. C.R. Weaver*, 169 F.3d 1310 (S.D. Fla. 1999) (no action for breach of implied covenant of good faith and fair dealing in absence of breach of express contract term; implied covenant cannot vary terms of express contract); *Orthonet v. A.B. Medical, Inc.*, 990 F.2d 387, 392 (8th Cir. 1993) (no independent claim for breach of implied covenant of good faith and fair dealing, independent of underlying breach of contract claim under Minnesota or Florida law, where underlying promise was barred by statute of frauds); *Alan's of Atlanta, Inc. v. Minolta*

Corp., 903 F.2d 1414, 1429 (11th Cir. 1990) (implied covenant of good faith and fair dealing is not independent term subject to breach apart from any other, but merely modifies meaning of explicit terms to prevent *de facto* breach when performance is maintained *de jure*); *Tanner v. Church's Fried Chicken, Inc.*, 582 So.2d 449, 452 (Ala. Sup. Ct. 1991) (duty of good faith is "directive, not remedial" and not actionable without breach of specific contract terms). C*f. Amoco Oil Co. v. Burns*, 496 Pa. 336, 342, 437 A.2d 381, 384 (1981) ("the duty of good faith and commercial reasonableness is used to define the franchisor's power to terminate the franchise only when it is not explicitly described in the parties' written agreements"). *See generally* 1 A. CORBIN, CONTRACTS § 96 (1963) (an agreement calling for successive performances but of indefinite duration was held to be terminable at the will of either party on reasonable notification).

47. *See, e.g., Carvel Corp. v. Baker*, 79 F. Supp. 2d 53 (D. Conn. 1997) (sales to supermarkets might violate duty of good faith, notwithstanding supplier's contractually reserved right, in supplier's "sole and absolute discretion," to sell in territory via the same or different distribution channels); *Mays v. Massey-Ferguson, Inc.,* 1990 U.S. Dist. LEXIS 10245, 1990 WL 80673, 1990-1 TRADE CAS. (CCH) ¶ 69,028, BUS. FRAN. GUIDE (CCH) ¶ 9617 (S.D. Ga. 1990) (termination after refusal to buy unwanted goods might constitute bad faith termination); *Sons of Thunder, Inc. v. Borden*, 148 N.J. 396 (1997) (termination of contract in accordance with explicit provision nevertheless breached covenant of good faith and fair dealing, where Borden had induced plaintiffs to buy and equip fishing boats and told plaintiffs' bank it expected contract to last for five years).

48. *DeTreville v. Outboard Marine Corp.*, 439 F.2d 1099 (4th Cir. 1971). *But see Puretest Ice Cream, Inc. v. Kraft, Inc.*, 806 F.2d 323 (1st Cir. 1986) (no implied good cause or good faith requirement for termination when contract permits termination without cause); *Keeney v. Kemper Nat'l Ins. Cos.*, 960 F. Supp. 617 (E.D.N.Y. 1997) (same); *Premiere Wine & Spirits of South Dakota, Inc. v. E. & J. Gallo Wines*, 644 F. Supp. 1431 (E.D. Cal. 1986) (same).

49. *Haagen-Dazs v. Masterbrand*, BUS. FRAN. GUIDE (CCH) ¶ 9570) (S.D. Ga. 1989) (S.C. law).

50. *See, e.g., Sofa Gallery, Inc. v. Stratford Co.,* 872 F.2d 259 (8th Cir. 1989); *Ag-Chem Equipment Co., Inc. v. Hahn, Inc.*, 480 F.2d 482, 486 (8th Cir. 1973). *See also Bartolomeo v. S.B. Thomas, Inc.*, 889 F.2d 530 (4th Cir. 1989); *Tractor and Farm Supply, Inc. v. Ford New Holland, Inc.*, 898 F. Supp. 1198 (W.D. Ky. 1995).

51. For the elements of these torts, *see, e.g., Unijax, Inc. v. Champion Int'l, Inc.*, 683 F.2d 678, 687 (2d Cir. 1982) (tortious interference with prospective business relations); *Halebian v. Roppe Rubber*, 718 F. Supp. 348 (D.N.J. 1989) (introduction of policy against transshipping might be tortious interference with relationship with customers distributor previously dealt with but was forbidden to sell to under new policy); *Shaitelman v. Phoenix Mut. Life Ins. Co.*, 517 F. Supp. 21, 24-25 (S.D.N.Y. 1980) ("prima facie tort" under New York law); *Robbins v. Ogden Corp.*, 490 F. Supp. 801, 810 (S.D.N.Y. 1980) (tortious interference with contracts).

52. *Carter Equip. v. John Deere Indus. Equip.*, 681 F.2d 386, 388-90 (5th Cir. 1982) (fiduciary duty); *Call Carl, Inc. v. BP Oil Corp.*, 554 F.2d 623 (4th Cir.), *cert. denied*, 434 U.S. 923 (1977) (fraud). *Cf. Arnott v. Am. Oil Co.*, 609 F.2d 873, 883-84 (8th Cir. 1979), *cert. denied*, 446 U.S. 918 (1980) (fiduciary duty); *Beehive Beer Distributing Corp. et al. v. Wisdom Import Sales Company, Inc. et al.* (E.D.N.Y. 2000) (fiduciary duty may arise out of a confidential relationship where one party assumes control and responsibility); *Koehler Enterprises, Inc. v. Shell Oil Co.*, BUS. FRAN. GUIDE (CCH) ¶ 10,252 (D. Md. 1993) (franchise relationship alone does not create fiduciary duty, but additional dealings between parties may do so; where franchisee was less sophisticated and "vulnerable," existence of fiduciary duty is question of fact); *Pickering v. Pasco Marketing, Inc.*, 303 Minn. 442, 228 N.W.2d 562 (1975) (applying the principle of unconscionability to limit a contractual termination right, focusing on circumstances surrounding the termination); *Shell Oil Co. v. Marinello*, 120 N.J. Super. 357, 294 A.2d 253 (Super. Ct. Law Div. 1972), *modified and aff'd*, 63 N.J. 402, 307 A.2d 598, *cert. denied*, 415 U.S. 920 (1974) (same); *Ashland Oil, Inc. v. Donahue*, 159 W. Va. 463, 223 S.E.2d 433 (1976) (same). *See generally* RESTATEMENT (SECOND) OF TORTS §§ 762-774A (1977) (where refusal to deal and intentional interference with contractual relations are present). *But see Crim Truck & Tractor Co. v. Navistar Int'l Transportation Corp.*, 30 Tex. Sup. Ct. J. 647 (6/12/91) (no fiduciary duty in franchise relationship); *Power Motive Corp. v. Mannesman Demag Corp.*, 617 F. Supp. 1048 (D. Colo. 1985) ("vast majority" of jurisdictions hold no fiduciary duty in franchise context) and cases cited therein.

53. *See, e.g., Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Development Corp.*, 38 Cal. App. 4th 985 (1995) (permitting fraud claim notwithstanding merger clause disclaiming any representations, warranties or inducements beyond those in the written agreement); *Century 21 v. Home Town Real Estate Co.*, 890 S.W.2d 118 (Tex. App. 1995) (grant of second franchise in territory, as permitted by written agreement, but contrary to oral policy, was unconscionable under Texas Deceptive Practices Act); *McEvoy Travel Bureau, Inc. v. Norton Co.*, 408 Mass. 704, 563 N.E.2d 188 (Mass. 1990) (giving effect to oral assurances that contractual termination provision was meaningless and relationship was long-term); *see also Commercial Property Investments, Inc. v. Quality Inns International, Inc.*, 938 F.2d 870 (1991) (finding oral representations supported claim of fraud despite contractual disclaimer of reliance on any such representations); *A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*, 162 Misc. 2d 941, 618 N.Y.S.2d 155 (Sup. Ct., N.Y.Co. 1994), *aff'd*, 214 A.D.2d 473, 625 N.Y.S. 904 (1st Dep't 1995), *modified on other grounds*, 87 N.Y.2d 574, 640 N.Y.S.2d 849 (1996) (oral representations supported claim of violation of franchise disclosure law despite contractual disclaimer of reliance on any such representations). *But see, e.g., Traumann v. Southland Corp.*, 842 F. Supp. 386 (N.D. Cal. 1993) (refusing to enforce oral promise that was contradicted by express written provision, but permitting good faith and fair dealing claims to proceed); *Carlock v. Pillsbury Co.*, 719 F. Supp. 791, 815, 817, 829-30 (D. Minn. 1989) (N.Y. law) (barring oral modification of contract with provision prohibiting oral modification; parol evidence admissible to clarify ambiguous contract terms or to show fraud in inducement of contract, but reliance unreasonable where contradicted by express written disclaimer); *Rosenberg v. Pillsbury Co.*, 718 F. Supp. 1146, 1152-53 (S.D.N.Y. 1989) (Mass. law) (similarly).

54. See note 1 *supra* for information on obtaining a more complete outline on the contents and drafting of distribution contracts.

55. *See, e.g., R&R Assocs. of Connecticut, Inc. v. Deltona Corp.*, BUS. FRAN. GUIDE (CCH) ¶ 7526 (D. Conn. 1980). *See generally* Spalty and Dicus, *Risky Business: Franchise Terminations for Failure to Meet Performance Quotas*, FRANCH. L.J., Spring 1987, at 1.

56. *See, e.g., Marquis v. Chrysler Corp.*, 577 F.2d 624, 632-33 (9th Cir. 1978) (the selective enforcement of an unrealistic quota may violate the federal Automobile Dealer's Day in Court Act).

57. This option may not be available in some industries in some states where the practice of "dualing" may be prohibited. *See, e.g.,* Ga. Regs. § 560-2-5.02 (Alcohol Beverage Control regulations).

58. *See* Cal. Bus. & Prof. Code §§ 20021, 20025 (West 1986 Supp.); Minn. Stat. Ann. § 80C.14(b), (c) (West 1986).

59. *See, e.g., Zee Medical Distributor Association, Inc. v. Zee Medical, Inc.*, 94 Cal. Rptr. 2d 829, 2000 Cal. App. LEXIS 307 (2000).

60. *Armstrong Business Services v. H&R Block*, 96 S.W.3d 867, BUS. FRAN. GUIDE (CCH) ¶12,485 (Mo. App. W.D. 2002).

61. *Nike Int'l Ltd. v. Athletic Sales, Inc.,* 689 F. Supp. 1235 (D.P.R. 1988).

62. *See, e.g.*, Cal. Bus. & Prof. Code § 20020 *et seq.*

63. The triggering event may include liens (other than routine financing liens), insolvency, the inability to pay debts as they become due, or bankruptcy. Note that if the agreement has not been terminated before a bankruptcy filing, section 365 of the Bankruptcy Code will allow the distributor the option to reject the contract or to affirm it and so prevent termination unless independent grounds for termination exist apart from the

bankruptcy. 11 U.S.C § 365. A termination notice given before the bankruptcy filing, but effective afterward, generally will be given effect, so long as only the passage of time is necessary for the termination to become effective, i.e., there is no right to cure remaining after the time of filing. *See Atlantic Rich field Co. v. Herbert*, 806 F.2d 889 (9th Cir. 1986); *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1212-13 (7th Cir. 1984). *But cf. In re Krystal Cadillac Oldsmobile GMC Truck, Inc.*, 142 F.3d 631, Bus. Fran. Guide (CCH) ¶ 11,389 (3d Cir. 1998) (where termination was not effective until rejection of appeal by Pennsylvania Vehicle Board, and appeal was not rejected until after bankruptcy filing, franchise agreement was part of bankruptcy estate and subject to automatic stay). This suggests providing for a right to terminate for insolvency prior to bankruptcy, although to terminate for insolvency, the supplier may be required to have had knowledge of the insolvency at the time of termination. *See Bruno Wine & Spirits, Inc. v. Guimarra Vineyards*, 573 F. Supp. 337 (E.D. Wis. 1983) (applying Wisconsin Fair Dealership Law).

64. *See, e.g.*, *Kealey Pharmacy & Home Care Service, Inc. v. Walgreen Co.*, 539 F. Supp. 1357 (W.D. Wis. 1982), *aff'd*, 761 F.2d 345 (7th Cir. 1985); *Westfield Centre Service, Inc. v. Cities Service Oil Co.*, 86 N.J. 453, 432 A.2d 48 (1981).

65. *See Doctor's Associates v. Casarotta*, 517 U.S. 681, 116 S. Ct. 1652 (1996); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 513 U.S. 1040, 115 S. Ct. 1212 (1995); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Southland v. Keating*, 465 U.S. 1 (1984); *KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 84 F.3d 42 (1st Cir. 1999) (upholding clause calling for arbitration outside Rhode Island despite franchise law provision that contract requiring venue outside Rhode Island is unenforceable); *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157 (2d Cir. 1998); *S+L+H S.p.A v. Miller - St. Nazianz, Inc.*, 988 F.2d 1518 (7th Cir. 1993); *Saturn Distribution Corp. v. Williams*, 905 F.2d 719 (4th Cir. 1990); *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc.*, 723 F.2d 155, 158 (1st Cir. 1983), *aff'd*, 473 U.S. 614 (1985); *Medika Int'l, Inc. v. Scanlan Int'l, Inc.*, 830 F. Supp. 81 (D.P.R. 1993); *Salon Brokers, Inc. v. Sebastian Int'l, Inc.*, Bus. Fran. Guide (CCH) ¶ 9586 (Mich. Ct. App. 1990); *but see Hambell v. Alphagraphics Franchising, Inc.*, 779 F. Supp. 910 (E.D. Mich. 1991); *Sterling Truck Corp. v. Sacramento Valley Ford Truck Sales,* 751 N.E.2d 517 (Ohio Ct. App. 2001), *appeal denied*, 748 N.E.2d 547 (Ohio 2001) (arbitration clause superseded by state law granting California New Motor Vehicle Board authority to determine existence of good cause for termination, because of severability clause which provided that "any provision of this Agreement which in any way contravenes any law of any relevant jurisdiction shall be deemed not to be a part of this Agreement in such jurisdiction"); *Barter Exchange, Inc. of Chicago v. Barter Exchange, Inc.*, 238 Ill. App. 3d 187, 179 Ill. Dec. 354, 606 N.E.2d 186 (Ill. App. Ct. 1992), *appeal denied,* 149 Ill. 2d 647, 183 Ill. Dec. 858, 612 N.E.2d 510 (Ill. 1993) (franchisor's failure to register under state franchise law made franchise agreement void, so arbitration clause was unenforceable); *contra Cusamano v. Norell Health Care, Inc.*, 239 Ill. App. 3d 648, 180 Ill. Dec. 352, 607 N.E.2d 246 (Ill. App. 1993) (rejecting *Barter Exchange, Inc. of Chicago, supra*, and enforcing arbitration, but rejecting choice of law clause).

66. *Laxmi Investments, LLC v. Golf USA*, 193 F.2d 1095, (9th Cir. 1999). *See also Great Earth Companies, Inc. v. Simons*, 2000 WL 640829, Bus. Fran. Guide (CCH) ¶ 11,823 (S.D.N.Y. 2000) (arbitration provision upheld but New York choice of forum unenforceable because franchisor had fraudulently misrepresented that Michigan Franchise Investment Law prohibited enforcement of out of state forum selection provision; franchisee reasonably relied on misrepresentation). *But see Bradley v. Harris Research, Inc.*, 2001 U.S. App. LEXIS 27284, Bus. Fran. Guide (CCH) ¶ 12,221 (9th Cir. 2001) (Federal Arbitration Act preempts California Franchise Investment Act provision making non-California forum clause unenforceable; distinguishing *Laxmi*, because plaintiff failed to show UFOC language suggesting clause might be unenforceable); *Gingiss Int'l, Inc. v. L&H Tuxes, Inc.*, Bus. Fran. Guide (CCH) ¶ 12,372 (N.D. Ill. 2002) at n.7 (criticizing *Laxmi* as disregarding preemptive effect of Federal Arbitration Act).

67. 10 Laws of P.R. Ann. § 278b-3.

68. *E.g.*, *Cellu-Beep, Inc. v. Telecorp., Inc.*, 322 F. Supp. 2d 122 (D.P.R. 2004) (even if contract was contract of adhesion, arbitration clause would be enforced); *Hawayek v. A.T. Cross Co.*, 221 F. Supp. 2d 254 (D.P.R. 2002) (Federal Arbitration Act preempts Puerto Rico Dealer's Act).

69. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 1921 (1989), *quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 105. S. Ct. 3346, 3354 (1985).

70. *Ledee v. Ceramiche Ragno*, 684 F.2d 184 (1st Cir. 1982) (enforcing selection of forum in spite of statute prohibiting arbitration outside Puerto Rico); but see *Great Earth Companies, Inc. v. Simons*, 2000 WL 640829, Bus. Fran. Guide (CCH) ¶ 11,823 (S.D.N.Y. 2000) (arbitration provision upheld but New York choice of forum unenforceable because franchisor had fraudulently misrepresented that Michigan Franchise Investment Law prohibited enforcement of out of state forum selection provision; franchisee reasonably relied on misrepresentation).

71. *Jones v. GNC Franchising, Inc.*, 211 F.3d 495 (9th Cir. 2000), *cert. denied*, 531 U.S. 928 (2000) (Pennsylvania forum selection clause in franchise agreement between California franchisee and Pennsylvania franchisor was violative of public policy expressed in California Franchise Relations Act and therefore unenforceable). In contrast, the opposite conclusion was reached a few months earlier by a district court in *Duarte v. GNC Franchising, Inc.*, Bus. Fran. Guide (CCH) ¶11,815 (C.D. Cal. 2000) (upholding Pennsylvania forum selection clause in franchise agreement between Pennsylvania franchisor and California franchisee, even though invalid under California Franchise Relations Act because federal law provided for consideration of forum selection clause in determining appropriateness of transfer, and the case did not turn on matters specific to any franchise store in California).

72. 471 U.S. 462 (1985).

73. *See, e.g.*, *ECC Computer Centers of Illinois, Inc. v. Entre Computer Centers, Inc.*, 597 F. Supp. 1182 (N.D. Ill. 1984); *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 146 N.J. 176, 680 A.2d 618 (N.J. 1996) (forum clause in contract arguably subject to Franchise Practices Act presumptively invalid; to rebut presumption, franchisor must show clause was not imposed on franchisee). *See also Davis v. Great American Cleaners, Inc.*, 1996 Mass. Super. LEXIS 218, Bus. Fran. Guide (CCH) ¶ 10,979 (Mass. Super. Ct. 1996) (forum clause not enforced due to unequal bargaining power, burden on franchisee). *But see Moseley v. Electronic Realty Associates, L.P.*, Bus. Fran. Guide (CCH) ¶ 11,430 (Ala. Ct. Civ. App. 1998) (enforcing Kansas choice of forum against Alabama franchisee).

74. *See, e.g.,* Ark. Laws of 1993, Act 310; Cal. Bus. & Prof. Code § 20040.5; 10 Laws of Puerto Rico Ann. §278c.

75. *Stewart Organization, Inc. v. Ricoh Corp.*, 487 U.S. 22 (1988).

76. *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S. Ct. 1522 (1991). *See Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 821 F. Supp. 802 (D.P.R. 1993) (enforcing choice of German forum in international agreement despite local dealer protection law), *reversed on other grounds,* 19 F.3d 745, 754 (1st Cir. 1994) (Breyer, C.J.) (remanding to determine whether forum clause covered antitrust and dealer protection law claims). *See also Dickerson v. Signs Now, Inc.*, 1994 WL 184442, Bus. Fran. Guide (CCH) ¶ 10,573 (E.D. Pa. 1994) (enforcing Alabama choice of forum in franchise agreement).

77. *Eisaman v. Cinema Grill Systems, Inc.*, 87 F. Supp. 2d 446 (D. Md. 1999).

78. *Moses v. Business Card Express, Inc.*, 929 F.2d 1131 (6th Cir. 1991).

79. *Silverman v. Carvel Corp.*, 2001 U.S. Dist. LEXIS 21095, Bus. Fran. Guide (CCH) ¶ 12,228 (W.D. N.Y. 2001).

80. *Cadapult Graphic Systems, Inc. v. Tektronix Inc.*, 98 F. Supp. 2d 560 (D.C. N.J. 2000) (28 U.S.C. § 1404(a) was applied so that valid forum selection clause selecting Oregon was entitled to substantial

consideration and enforced against plaintiff in the absence of evidence of fraud or overreaching).

81. *Marel Corp. v. Encad Inc.*, 2001 U.S. Dist. LEXIS 21209, Bus. Fran. Guide (CCH) ¶ 12,227 (D.P.R. 2001).

82. *See Docksider, Ltd. v. Sea Technology, Ltd.*, 875 F.2d 762 (9th Cir. 1989).

83. *Stawski Distributing Co., Inc. v Browery Zywieg, S.A.*, 349 F.2d 1023 (7th Cir. 2003).

84. *See, e.g.*, *Instructional Systems, Inc. v. Computer Curriculum Corp.*, 130 N.J. 324, 341-46, 614 A.D.2d 124, 133-35 (N.J. 1992); *Dunes Hospitality, LLC v. Country Kitchen International, Inc.*, 623 N.W.2d 484 (S.D. Sup. Ct. 2001) (choice of Minnesota law disregarded because forum state public policy would be violated and most significant contacts occurred in forum state); *Covert Chevrolet-Oldsmobile, Inc. v. General Motors Corp.* No. 05-00-01170-CV, 2001 WL 950274 (Tex. App. Aug. 21, 2001) (not designated for publication) (Texas law applied to indemnification claim by dealer for costs of lawsuits against it brought in Texas by Texas residents despite choice of law provision selecting Michigan law; Texas had most significant relationship to dispute); *Ticknor et al. v. Choice Hotels Int'l*, 265 F.3d 931 (9th Cir. 2001) (choice of Maryland law in a motel franchise agreement not enforced based on fact that only contact between franchisor and franchisee took place in Montana, the motel was operated in Montana and Maryland law would have violated Montana public policy); *Guild Wineries and Distilleries v. Whitehall Co., Ltd.*, 853 F.2d 755 (9th Cir. 1988) (giving preclusive effect to administrative ruling refusing to enforce choice of law provision); *Caribbean Wholesales and Service Corp. v. US JVC Corp.*, 855 F. Supp. 627, 633 (S.D.N.Y. 1996) (application of contractual choice of New York law would violate public policy of Puerto Rico); *Winer Motors, Inc. v. Jaguar Rover Triumph, Inc.*, 208 N.J. Super. 666, 506 A.2d 817 (N.J. Super. 1986); *South Bend Consumer Club, Inc. v. United Consumers Club, Inc.*, 572 F. Supp. 209 (N.D. Ind. 1983); *R&R Associates of Connecticut, Inc. v. Deltona Corp.*, Bus. Fran. Guide (CCH) ¶ 7526 (D. Conn. 1980). *Ingmar GB Ltd. v. Eaton Leonard Technologies, Inc.*, Case C-381/98 (Times Law Report 16.11.00) (the European Court of Justice held that the English Commercial Agents Regulations must be applied where a commercial agent carried on his activities in a member state although the principal was based in a non-member state and the license agreement was governed by California law).

85. *See, e.g., Unarce v. Staff Builders,* Bus. Fran. Guide (CCH) ¶ 10,746 (9th Cir. 1996) (not for publication) (choice of law clause not enforced where validity of agreement containing it is challenged).

86. *See, e.g. JRT, Inc. v. TCBY Systems, Inc.*, 52 F.3d 734, (8th Cir. 1995) (enforcing choice of Arkansas law despite Michigan Franchise Investment Law antiwaiver provision because provision did not specifically address choice of law clauses); *Cherokee Pump & Equipment, Inc. v. Aurora Pump*, 38 F.3d 246 (5th Cir. 1994) (enforcing choice of Illinois law to permit termination of Louisiana distributorship in manner prohibited by Louisiana statute); *Modern Computer Systems, Inc. v. Modern Banking Systems, Inc.*, 871 F.2d 734 (8th Cir. 1989) (enforcing contractual choice of law clause); *Tele-Save Merchandising Co. v. Consumers Distributing Co.,* 814 F.2d 1120 (6th Cir 1987) (same); *Carousel Systems, Inc. v. Ordway*, 1996 WL 208359, Bus. Fran. Guide (CCH) ¶ 10,914 (E.D. Pa. 1996); *Banek Inc. v. Yogurt Ventures, U.S.A., Inc.*, Bus. Fran. Guide (CCH) ¶ 10,112 (E.D. Mich 1992) (enforcing contractual choice of law clause), *aff'd*, 6 F.3d 357 (6th Cir. 1993) (not designated for publication) (state franchise law antiwaiver provision did not preclude enforcing choice of law clause in absence of provision barring such clauses); *Cottman Transmission Systems, Inc. v. Melody*, 869 F. Supp. 1180, 1188 (E.D. Pa. 1994) (enforcing choice of Pennsylvania law, which does not cause substantial erosion of California statutory rights, to dismiss franchisee claims under California Franchise Investment Law); *Hardee's Food Systems, Inc. v. Bennett*, 1994 WL 1372628, Bus. Fran. Guide (CCH) ¶ 10,453 (S.D. Fla. 1994) (enforcing contractual choice of N.C. law, rejecting claim under Fla. franchise statute); *Faltings v. Int'l Bus. Machines Corp.*, 854 F. 2d 1316 (Table), 1988 WL 83316 (4th Cir. 1988) (not designated for publication) (enforcing contractual choice of law clause); *United Wholesale Liquor Co. v. Brown-Forman Distillers Corp.*, 108 N.M. 467, 775 P.2d 233 (N.M. 1989) (enforcing contractual choice of law clause); *Carlock v. Pillsbury Co.,* 719 F. Supp. 791 (D. Minn. 1989) (same). *But see Electrical and Magneto Service Co. v. AMBAC Int'l Corp.*, 941 F.2d 660 (8th Cir. 1991) (refusing to honor contractual choice of law clause); *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128 (7th Cir. 1990) (same); *Caribbean Wholesales & Service Corp. v. US JVC Corp.*, 855 F. Supp. 627 (S.D.N.Y. 1994) (same); *Flynn Beverage Inc. v. Joseph E. Seagram & Sons, Inc.*, 815 F. Supp. 1174 (C.D. Ill. 1993) (same); *Economou v. Physicians Weight Loss Centers of America*, 1991 WL 185217, Bus. Fran. Guide (CCH) ¶ 9836 (N.D. Ohio 1991) (same); *Scott v. Snelling and Snelling, Inc.*, 732 F. Supp. 1034 (N.D. Colo. 1990) (same). *Cf. Pelican State Supply Co., Inc. v. Cushman, Inc.*, 39 F.3d 1184 (8th Cir. 1994) (unpublished opinion) (choice of Nebraska law did not make Nebraska state dealer law applicable to out-of-state dealer, where statute by its terms governed only dealers in Nebraska).

87. *Grand Kensington, LLC v. Burger King Corp.*, 81 F. Supp. 2d 834 (E.D. Mich. 2000).

88. *Solman Distributors, Inc. v. Brown-Forman Corp.,* 888 F.2d 170 (1st Cir. 1989).

89. *Electrical and Magneto Service Co.,* note 86 *supra*, at 663-64 (distinguishing *Modern Computer Systems,* note 86 *supra.*

90. *LaGuardia Associates v. Holiday Hospitality Franchising, Inc.*, 92 F. Supp. 2d 119 (E.D.N.Y. 2000) (Tennessee choice of law provision between New York franchisee and Georgia franchisor unenforceable for lack of rational relationship to state).

91. *Compare Faltings v. Int'l Bus. Machines Corp.*, 854 F. 2d 1316 (Table), 1988 WL 83316 (4th Cir. 1988) (not designated for publication) (choice of New York law precludes application of more restrictive New Jersey Franchise Practices Act); *Barnes v. Burger King Corp.*, 932 F. Supp. 1441 (S.D. Fla. 1996) (California franchisee lacked standing to assert claim under Florida Franchise Act, despite contractual choice of Florida law); and *Edelen and Boyer Co. v. Kawasaki Loaders, Inc.*, 1992 WL 236909, Bus. Fran. Guide (CCH) ¶ 10,171 (E.D. Pa. 1992) (Georgia heavy equipment dealer law not applicable to franchises outside Georgia, notwithstanding choice of Georgia law in franchise agreement); *with Tractor and Farm Supply, Inc. v. Ford New Holland, Inc.*, 898 F. Supp. 1198 (W.D. Ky. 1995); *Burger King Corp. v. Austin*, 805 F. Supp. 1007, 1022-23 (S.D. Fla. 1992) (allowing counterclaim by Georgia franchisees under Florida Franchise Act where franchise agreement chose Florida law); *McGowan v. Pillsbury Co.*, 723 F. Supp. 530 (W.D. Wash. 1989) (allowing claim that New York Franchise Sales Act was violated where agreement with Washington franchisee chose New York law); *and Dep't of Motor Vehicles v. Mercedes-Benz*, 408 So. 2d 627 (Fla. 1981), *modified*, 455 So.2d 404 (Fla. 1984) (applying New Jersey Franchise Practices Act to Florida franchise where contract chose New Jersey law).

92. *See Valley Juice Ltd., Inc. v. Evian Waters of France, Inc.*, 87 F.3d 604 (2d Cir. 1996) (choice of New York law to govern agreement did not preclude claim under Massachusetts "little FTC Act," as it would have had the agreement also stated rights of parties were to be governed by New York law); *see also Heating & Air Specialist, Inc. v. Jones*, 180 F.3d 923 (8th Cir. 1999) (provisions that Texas law governed "interpretation" of contract applied only Texas rules of statutory construction, not Texas substantive law).

93. United Nations Convention on Contracts for the International Sales of Goods, S. Treaty Doc. No. 9, 98th Cong., 1st Sess. 22 (1983), reprinted at 15 U.S.C. app. 52 (1997) (the "CISG").

94. CISG arts. 1, 6.

95. CISG art. 11.

96. CISG art. 29.

97. CISG art. 8; *MCC-Marble Ceramic Center, Inc. v. Ceramica Noyvo d'Agostino, S.p.A.*, 144 F.2d 1384 (11th Cir. 1998) (parol evidence is

to be admitted and considered as to parties' intent, even if the oral conduct contradicts the written contract).

98. CISG art. 19 (no contract results if acceptance contains terms that materially alter the offer).

99. *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co., Inc.*, 2001 U.S. Dist. LEXIS 15191, 2001WL 1000927 (N.D. Ill. 2001) (awarding attorneys' fees to prevailing party under CISG Art. 74 as expenses stipulated by parties as foreseeable to be incurred as a result of breach).

100. 9 U.S.C. § 1 *et seq.*

101. *See, e.g., Good(E) Business Systems, Inc. v. Raytheon Co.*, 614 F. Supp. 428, 430-31 (W.D. Wis. 1985). *See also Volt Information Sciences, Inc. v. Stanford University*, 489 U.S. 468 (1989) (choice of California law included California rules regarding arbitrability, which were applied to stay arbitration); *Yates v. Doctor's Assocs., Inc.* 140 Ill. Dec. 359, 193 Ill. App. 3d 431, 549 N.E.2d 1010 (Ill. App. 1990).

102. *E.g., Wasserman's Inc. v. Township of Middletown*, 137 N.J. 238, 251, 645 A.2d 100 (1994) ("provisions for liquidated damages are enforceable only if 'the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach").

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NYSBA Guidelines for Obtaining MCLE Credit for Writing

Under New York's Mandatory CLE Rule, MCLE credits may be earned for legal research-based writing, directed to an attorney audience. This might take the form of an article for a periodical, or work on a book. The applicable portion of the MCLE Rule, at Part 1500.22(h), states:

> *Credit may be earned for legal research-based writing upon application to the CLE Board, provided the activity (i) produced material published or to be published in the form of an article, chapter or book written, in whole or in substantial part, by the applicant, and (ii) contributed substantially to the continuing legal education of the applicant and other attorneys. Authorship of articles for general circulation, newspapers or magazines directed to a non-lawyer audience does not qualify for CLE credit. Allocation of credit of jointly authored publications should be divided between or among the joint authors to reflect the proportional effort devoted to the research and writing of the publication.*

Further explanation of this portion of the rule is provided in the regulations and guidelines that pertain to the rule. At section 3.c.9 of those regulations and guidelines, one finds the specific criteria and procedure for earning credits for writing. In brief, they are as follows:

- The writing must be such that it contributes substantially to the continuing legal education of the author and other attorneys;
- it must be published or accepted for publication;
- it must have been written in whole or in substantial part by the applicant;
- one credit is given for each hour of research or writing, up to a maximum of 12 credits;
- a maximum of 12 credit hours may be earned for writing in any one reporting cycle;
- articles written for general circulation, newspapers and magazines directed at nonlawyer audiences do not qualify for credit;
- only writings published or accepted for publication after January 1, 1998 can be used to earn credits;
- credit (a maximum of 12) can be earned for updates and revisions of materials previously granted credit within any one reporting cycle;
- no credit can be earned for editing such writings;
- allocation of credit for jointly authored publications shall be divided between or among the joint authors to reflect the proportional effort devoted to the research or writing of the publication;
- only attorneys admitted more than 24 months may earn credits for writing.

In order to receive credit, the applicant must send a copy of the writing to the New York State Continuing Legal Education Board, 25 Beaver Street, 8th Floor, New York, New York 10004. A completed application should be sent with the materials (the application form can be downloaded from the Unified Court System's Web site, at this address: www.courts.state.ny.us/mcle.htm (click on "Publication Credit Application" near the bottom of the page)). After review of the application and materials, the Board will notify the applicant by first-class mail of its decision and the number of credits earned.

The Modern View of the "Fair and Equitable Treatment" Standard in the Review of Regulatory Action by States

By Robert Wisner

I. Introduction

This article deals with the application of the "fair and equitable treatment" standard in the review of regulatory action by states. The topic is a broad one. Nearly every investor-state arbitration today involves an allegation of a breach of the "fair and equitable treatment" obligation.

It is not surprising then that fair and equitable treatment is also the source of much discussion at conferences such as the Annual Meeting of the NYSBA's International Law and Practice Section. Often, these discussions are very scholarly. Sometimes, however, these discussions generate more heat than light. For example, after a lengthy debate considering the appropriate antonym for the words "fair and equitable"—should it be "arbitrary conduct" or merely conduct lacking "even-handedness"—the speaker may conclude with a statement that provides little guidance to disputing parties e.g. "it's a contextual standard that depends on all of the facts of the case."

As a practitioner, I do not think it fair to either respondent states or claimants to advise them only that liability will depend on all the facts of the case. States undertaking regulatory action need to know in advance whether these actions will trigger potential claims in the hundreds of millions of dollars. Potential claimants considering an investment of several million dollars in fees for legal representation, expert witnesses and arbitration costs need to know the likelihood of success. Although it is important to stress that the application of this treaty standard depends heavily on the factual context, clients look to us for guidance regarding which facts make the difference for the success or failure of a claim.

I argue below that we can now draw some conclusions about the meaning of "fair and equitable treatment" with relative confidence. In particular:

(a) State action that violates old, well-established categories of the customary international law minimum standard of treatment of aliens (e.g., denial of justice) will breach the "fair and equitable treatment" obligation.

(b) At the same time, the obligation covers actions that go beyond the older case law—either because customary international law has evolved in the past 80 years or because treaties have established a new, independent standard.

(c) The "new" standard protects the legitimate expectations of foreign investors. It is not an open-ended license for tribunals to evaluate "fairness."

(d) Legitimate expectations are determined by an objective test. Although evidence regarding the subjective intentions of the state and the subjective expectations of investors may be relevant, it is not determinative.

(e) Legitimate expectations are derived from the host state's regulatory framework, the representations of its government officials and the reasonableness of the investor's reliance on the stability of the regulatory framework.

In order to try to isolate these critical features of successful "fair and equitable treatment" claims, this article will start with the birth of modern investor-state arbitration about ten years ago: NAFTA chapter 11 cases. This article will then consider the reaction to some of the early NAFTA cases by the NAFTA governments and later tribunals established under both NAFTA and bilateral investment treaties. Finally, this article will consider whether there is now a consistent interpretation in both NAFTA and BIT tribunals of the words "fair and equitable treatment."

II. One Treaty Standard or Many?

The first modern investor-state disputes to consider the meaning of "fair and equitable treatment" were a set of early NAFTA cases. Three of these cases were brought against the government of Canada[1] and a fourth[2] was subject to judicial review proceedings in Canada. The at least partial success of claimants in each of these cases was no doubt responsible for stimulating the growth of investor-state arbitration. One can therefore blame (or thank) a small group of Canadian lawyers for this burgeoning area of practice.

Before considering the NAFTA experience, let us address its relevance for lawyers from non-NAFTA countries. The words "fair and equitable treatment" in NAFTA Article 1105 appear in a context that is slightly different from many BITs that are not based on the NAFTA model.[3] This context is as follows:

(a) Article 1105 appears under the heading "Minimum Standard of Treatment"; and

(b) "fair and equitable treatment" is included along with "full protection and security" as one of two

examples of "treatment in accordance with international law."

Do these textual differences suggest that NAFTA is a *lex specialis* which does not readily assist with the interpretation of differently worded treaty obligations? I would argue that they do not for the following reasons:

(i) The NAFTA governments were each parties to a number of other investment treaties when they negotiated NAFTA. It is unlikely that they sought to negotiate a different standard of treatment to apply among themselves. It is still less likely that they were intending to set a lower standard among themselves as opposed to their other treaty partners.

(ii) NAFTA negotiators would have been aware that their existing bilateral investment treaties (BITs) were based on the 1967 OECD Draft Convention on the Protection of Foreign Property that was followed by other capital-exporting states. The 1967 draft, in turn, was based on the Abs-Shawcross Draft Convention on Investments Abroad of 1959, which preceded the signing of the first BITs. It is unlikely that small variations on this original wording were intended to lead to significant differences in interpretation. Rather, variations were intended to clarify earlier treaty language.

Thus, the lessons of NAFTA should apply to all BITs, and vice-versa. The more difficult question is whether NAFTA's use of the heading entitled "Minimum Standard of Treatment" and NAFTA's reference to "treatment in accordance with international law" are evidence that fair and equitable treatment in all BITs is equivalent to the customary international law standard of treatment of aliens, as opposed to being an independent treaty standard.

In each of the early NAFTA cases, respondents argued that Article 1105 merely referred to the customary international law standard for the treatment of aliens. According to this argument, Article 1105 was intended to settle the debate sparked by Carlos Calvo as to whether aliens should ever be entitled to treatment that was better than the treatment accorded to nationals. It did so by incorporating into the treaty a body of decisions from early twentieth-century mixed-claims tribunals that dealt primarily with denials of justice by local courts and abuses of the police powers of detention or expulsion. These decisions also included the doctrine of "full protection and security," which imposed a due diligence obligation on police, fire or other public protection authorities. Finally, respondents argued that the well-known *Neer*[4] claim articulated the content of this standard of treatment when the U.S.-Mexico Claims Commission said that "the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would recognize its insufficiency."[5]

By contrast, claimants pointed out that the word "customary" did not appear anywhere in Article 1105. Although agreeing that the customary international law standard of treatment was included in Article 1105, claimants argued that its content went beyond that standard. Relying on the commentary of the eminent British jurist F.A. Mann, claimants alleged Article 1105 established an independent, overriding standard of treatment. These arguments appear to have prevailed in all the early NAFTA cases.

III. NAFTA and the Birth of Modern Investment Arbitration

The first modern investment treaty award on the merits to consider the meaning of "fair and equitable treatment" was the decision of the NAFTA Tribunal in *Azinian v. Mexico*.[6] Claimants in that case challenged the termination of a concession contract before the NAFTA tribunal after they had lost their case in the Mexican courts. The tribunal dismissed the claim on the grounds that a court declaration of the nullity of a contract could only be challenged, directly or indirectly, if it had been a denial of justice. There was no suggestion that the Mexican courts had denied justice in that case.

Azinian demonstrated the importance of customary international law in the interpretation of what constitutes fair and equitable treatment. Customary international law served as the background framework through which the "fair and equitable treatment" claim was evaluated. However, the case did not involve a review of regulatory conduct. Rather, it dealt with an old-fashioned issue regarding the treatment of an alien's contractual rights by a local court.

By contrast, the review of regulatory conduct was squarely in issue in the next NAFTA award on the merits: *Metalclad v. Mexico*.[7] In that case, municipal authorities denied a construction permit citing environmental concerns. Metalclad, however, had relied on federal environmental approvals and representations from federal officials that its proposed facility met all environmental requirements. Drawing on the objectives of NAFTA, the Tribunal concluded that the obligation of fair and equitable treatment implied that relevant legal requirements should be capable of being readily known by investors and federal officials had a duty to correct any misunderstandings generated by their representations.

Metalclad represents the first attempt to interpret the meaning of the obligation of fair and equitable treatment in light of the object and purpose of the treaty. Remarkably, this part of the award was later annulled by a court of the province of British Columbia, Vancouver being the seat of the arbitration. The B.C. court character-

ized the award, unfairly in this author's opinion, as being based on obligations contained in other chapters of NAFTA dealing with transparency and, therefore, outside the scope of Chapter 11. The bulk of the damage award was only saved by a separate finding of expropriation resulting from a later measure.

The partial annulment of an arbitral award by a distinguished international tribunal chaired by Sir Eli Lauterpacht, due largely to apparent misunderstanding of the tribunal's use of a standard treaty interpretation tool, has been the subject of extensive commentary. Although the British Columbia decision has now been confined to its facts by more recent Canadian court decisions,[8] it continues to cast a cloud on the validity of *Metalclad* as proper authority.

Metalclad was quickly followed by two NAFTA awards against the government of Canada, *S.D. Myers*[9] and *Pope & Talbot*.[10] Both cases confirmed that modern, developed country governments could be found liable for breaches of the "fair and equitable treatment" obligation.

In *S.D. Myers*,[11] liability arose out of an environmental decree banning cross-border shipments of PCB waste. The tribunal found that the decree was enacted to prevent an American waste remediation firm from competing with a Canadian one, not for any valid environmental objective. The unanimous tribunal found this violated the national treatment obligation. A majority also found that Canada had violated the fair and equitable treatment obligation.

The discussion of NAFTA Article 1105 in *S.D. Myers* can be relied upon by both sides in the debate on fair and equitable treatment. Supporters of the theory that Article 1105 merely refers to the customary international law standard can point to the tribunal's comments that Article 1105 requires an investor to be treated in such "an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective."[12] They can also point to the tribunal's finding that the government decree was enacted for improper motives, targeted a foreign investor and was essentially a bad faith and discriminatory exercise of regulatory power.

Claimants, however, will point to the tribunal's endorsement of F.A. Mann's view that fair and equitable treatment is an independent, overarching standard and that the breach of another treaty provision (i.e., national treatment) weighed heavily in finding a breach of Article 1105.[13] They can also point out that the facts involved environmental regulation, not the denials of justice or abuses of police authority usually addressed in older customary international law.

The *Pope & Talbot* decision, by contrast, left no doubt about its approach. For that tribunal, Article 1105 was additive. The standard covered both the customary minimum standard under international law *plus* an independent fairness element. The tribunal reached this conclusion by surveying the language of BITs to which Canada and the U.S. were a party and rejecting the view that the old *Neer* standard of "egregious," "outrageous" or "shocking" treatment was applicable.[14]

Unfortunately, the *Pope & Talbot* tribunal gave little indication as to the content of the independent fairness standard beyond the rather vague, ordinary meaning of "fair and equitable." It rejected claims that the regulation of export quotas was unfair, but upheld an ancillary claim based on a government audit that followed the initiation of the NAFTA arbitration. The audit lacked legal foundation and was a coercive attempt to force the claimant to relinquish legal rights. In its later award on damages, the tribunal commented that the audit would even violate basic customary international law standards as they stood at the time of the *Neer* decision.[15] We now turn to the developments that required this later statement by the tribunal.

IV. The NAFTA Interpretation, CAFTA and New BITs

The reaction of NAFTA governments to *Metalclad*, *S.D. Myers* and *Pope & Talbot* was swift. On 31 July 2001, the NAFTA Ministers of International Trade, sitting as the Free Trade Commission (FTC), issued an Interpretation declaring that Article 1105 reflects the customary international law minimum standard of treatment and does not require treatment beyond what is required by customary international law.

The FTC interpretation language has now found itself into the Model BITs of both the United States and Canada as well as in CAFTA. Indeed, CAFTA goes even further than the FTC Interpretation. It reads:

> **Article 10.5: Minimum Standard of Treatment**
>
> 1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
>
> 2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
>
> (a) "fair and equitable treatment" includes the obligation not to deny justice

in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

(b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.

For good measure, CAFTA even adds an annex with the standard definition of customary international law.[16]

By declaring that "fair and equitable treatment" includes the obligation not to deny justice but not any other standard, CAFTA raises the possibility of an *expresio unis* interpretation that would have "fair and equitable treatment" be essentially synonymous with denials of justice. This issue has not yet been considered by a CAFTA Tribunal.

By contrast, the FTC interpretation has been the subject of extensive consideration by NAFTA tribunals. Six years later, no claimant has succeeded in establishing a violation of Article 1105 by a NAFTA government. At the same time, the jurisprudence suggests that the true impact of the FTC interpretation has been minimal.

V. Reaction to the NAFTA Interpretation—NAFTA Tribunals

Since the FTC interpretation was adopted, every NAFTA tribunal has accepted that it is binding—even though the *Pope & Talbot*[17] tribunal suggested *in obiter* that it was an improper amendment rather than an interpretation. At the same time, nearly every tribunal has declared that the customary international law standard was not "frozen in amber" at the time of the Mexican-American Claims Commission of the 1920s.

Indeed, as the *Mondev*[18] tribunal pointed out, it is doubtful that the *Neer* decision ever reflected the customary international law standard of treatment for foreign investment as opposed to the standard for review of police investigations into attacks on the physical security of aliens. References to the *Neer* standard of treatment often neglect to mention that this case attempted to hold Mexico responsible for the failure to apprehend or punish private citizens who murdered a U.S. national. States are not ordinarily responsible for acts of private persons.

In the NAFTA context, the debate over fair and equitable treatment has therefore shifted to one regarding the content of customary international law standards of treatment as they stand today. The following principles of customary international law have been established by recent cases:

(a) the inquiry into fair and equitable treatment is disciplined by being based on state practice and judicial or arbitral case law or other sources of legal authority, i.e., fairness is not based on the subjective sensitivities of the tribunal;[19]

(b) conduct may violate the fair and equitable treatment standard if it is merely "unjust or idiosyncratic," rather than being "outrageous" or "egregious";[20]

(c) bad faith is not a necessary element of a claim;[21]

(d) the obligation is a minimum standard detached from domestic law, that is, action that is legal under domestic law may violate the treaty;

(e) conversely, inconsistency with domestic law is not *ipso facto* a treaty violation[22]—in particular, a simple breach of contract by a government does not translate into a breach of fair and equitable treatment where the claimant is free to pursue recovery in local courts;[23]

(f) in applying the standard, it is relevant that the treatment is in breach of representations made by the host state that were reasonably relied upon by the claimant;[24]

(g) by considering representations of the host state, the standard protects legitimate expectations; however, this is an objective test and does not depend on the subjective expectations of the claimant;[25]

(h) customary international law does not preclude discrimination *per se*, i.e., mere differential treatment of nationals and aliens; however, conduct that is discriminatory and exposes the claimant to sectional or racial prejudice will violate the standard;[26]

(i) mere "maladministration" of a regulatory regime does not violate the "fair and equitable treatment" obligation, but it may do so if it rises to the level of "outright and unjustified repudiation" of the regulations.[27]

Thus, we now have a "new" standard of customary international law treatment of foreign investors: review of good faith regulatory conduct for consistency with legitimate expectations.

VI. Reaction to the NAFTA Interpretation—BIT Tribunals

BIT tribunals have not been bound by the NAFTA interpretation and have consistently used this freedom to declare that fair and equitable treatment is an autonomous standard that goes beyond customary international law.

Two of the first BIT awards on fair and equitable treatment, *Maffezini* and *CME*,[28] took it for granted that violations of the "fair and equitable treatment" obliga-

tion would occur due to a lack of "transparency" or a revocation of the legal basis upon which the foreign investor was induced to invest. The fairly brief reasons of these tribunals were very similar to those of the *Metalclad* tribunal.

The only early BIT case that may have supported a contrary interpretation, *Genin v. Estonia*,[29] was clarified recently by the *Saluka v. Czech Republic*[30] tribunal which included Mtre. Yves Fortier, the president of the *Genin* tribunal. The *Saluka* tribunal commented as follows:

> Far from equating the BIT's standard with the customary minimum standard, the *Genin* tribunal merely emphasized that the "fair and equitable treatment" standard requires Contracting States to accord foreign investors treatment which does not fall below a certain minimum, this minimum being in any case detached from any lower minimum standard that may prevail in the domestic laws of the Contracting States.[31]

Since *Genin*, nearly a dozen BIT tribunals have considered the meaning of fair and equitable treatment. None of them have equated it to the customary international law standard of treatment of aliens, let alone the *Neer* standard.

It was only four years ago, in the case of *Tecmed v. Mexico*,[32] that the rationale for these findings was fully articulated. The *Tecmed* tribunal explained that the requirement to provide fair and equitable treatment was to be given an "autonomous interpretation," i.e., one based on the application of the Vienna Convention on the Law of Treaties[33] and the principle of good faith. These principles direct the tribunal to apply the ordinary meaning of the words, in their context and in light of the treaty's object and purpose, rather than applying a special meaning limiting the words to the traditional categories of the minimum standard of treatment of aliens. Such a special meaning can only be applied when there is clear evidence to support this intent.

More recently, tribunals have addressed arguments that references to fair and equitable treatment in the context of "treatment in accordance with international law" should lead to a different interpretation. The *Vivendi v. Argentina*[34] tribunal held that there is "no basis for equating principles of international law with the minimum standard of treatment" of aliens. Following *Azurix v. Argentina*,[35] it held that conformity with international law "can just as readily set a floor as a ceiling on the Treaty's fair and equitable treatment standard."[36]

Yet, just as the NAFTA debate shifted following the FTC interpretation to one over the modern meaning of customary international law, so too the BIT debate has shifted to one over the autonomous meaning of the "fair and equitable treatment" standard. This debate has led to many of the same results as in the NAFTA cases, albeit by a different route.

VII. NAFTA and BIT Jurisprudence: Is There a Difference?

In applying the principles of the Vienna Convention on the Law of Treaties, BIT jurisprudence interpreting "fair and equitable treatment" obligations typically starts with the ordinary meaning of the words. These discussions, however, rarely shed much light on the tribunal's analysis. The choice of adjective does not determine the success of the claim.

Instead, the content of fair and equitable treatment is often drawn from the economic objectives of the treaties and, consequently, focuses on the role of a stable regulatory environment in promoting investment. *Occidental v. Ecuador*[37] and later cases dealing with U.S. BITs have emphasized the preamble of the treaties that records the agreement of the parties that "fair and equitable treatment is desirable to maintain a stable framework for investment and maximum effective utilization of economic resources."[38]

The *Tecmed*[39] case was one of the first to emphasize stability of the regulatory framework and legitimate expectations, but drew this requirement from the application of the principle of good faith. Nearly every subsequent BIT case has referred to respect for legitimate expectations as part of the "fair and equitable treatment" standard.

The more controversial question relates to the manner in which the content of legitimate expectations are determined. The *Tecmed* decision described the host State's duty in this regards as follows:

> [T]o provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host

> State to act consistently, i.e., without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation.[40]

This dictum has generated some controversy because of the breadth of obligations imposed on the state. Recently, the *MTD v. Chile* Annulment Committee[41] stated that it appreciated some of the criticisms and clarified that the actual set of expectations that an investor may have, or may claim to have, does not impose obligations on the host state. There was no dispute, however, that legitimate expectations generated by the investor's dealings with competent officials were relevant to the application of the standard.[42]

Since *Tecmed*, most BIT decisions finding a breach of the "fair and equitable treatment" obligation have involved a change to the regulatory system that was the basis for the investment. This does not imply that any regulatory change leads to compensation for foreign investors. Rather, compensation must occur if there has been some commitment given by the government. Examples of such commitments include the following:

(a) Concession contracts as in the pre-crisis[43] or post-crisis[44] Argentine cases;

(b) Production sharing contracts;[45] and

(c) Foreign investment approvals.[46]

In addition to the cases challenging regulatory measures, claimants have had some success where legitimate expectations were violated by failure to fulfill contractual commitments[47] or by misrepresentations in contractual negotiations.[48] Finally, in the *Saluka*[49] decision, a discriminatory allocation of state aid appears to have been the basis of a violation of the "fair and equitable treatment" obligation even though no firm government commitment to the investor was identified.

In this author's opinion, these non-regulatory cases are somewhat problematic. They may suggest that the requirement of fair and equitable treatment can extend to actions that do not involve an exercise of sovereign authority by a state or do not involve legitimate expectations fostered by regulations and the conduct of government officials. The purely contractual cases, in particular, are difficult to reconcile with the well-established customary international law rule that simple breaches of contract by the host state do not create an international wrong.[50]

In addition to ordinary meaning and objects and purpose, the Vienna Convention on the Law of Treaties directs tribunals to consider the context of the obligation. Investment treaties often contain umbrella clauses that address contractual obligations or obligations of national treatment that address differential treatment of similar investments. The principle of effectiveness implies that fair and equitable treatment should not be coextensive with these other obligations. These distinctions are especially important when treaties choose to avoid umbrella clauses or create extensive exceptions and reservations to national treatment that do not apply to fair and equitable treatment.

VIII. Conclusion

Six years after the controversy over the NAFTA FTC interpretation, with some minor exceptions, the legal standards applied by BIT tribunals have not been substantially different from those applied by NAFTA tribunals. This is not because BIT tribunals have applied lower standards of old customary international law, but because NAFTA tribunals have declared an evolution of customary international law. In this regard, the *CMS Gas Transmission Co. v. Argentina*[51] tribunal declared the following:

> The required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international minimum standard and its evolution under customary law.[52]

Of course, readers of the old mixed-claims commission cases will have difficulty finding cases dealing with changes to tariffs for regulated public utilities, the revocation of environmental and broadcasting permits and municipal zoning rules. Yet, this does not mean that such issues were excluded from the international minimum standard for aliens. Rather, these manifestations of the modern regulatory state did not exist in the 1920s. The world has changed since then and customary international law has changed with it.

Endnotes

1. *Ethyl Corp. v. Canada,* Decision on Jurisdiction dated 24 June 1998; *S.D. Myers v. Canada*, Partial Award on Liability dated 13 Nov. 2000; and *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2 dated 10 Apr. 2001.
2. *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, 40 I.L.M. 36 (2001).
3. Paragraph 1 of Article 1105 of NAFTA, entitled "Minimum Standard of Treatment," provides that "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."

4. *Neer* Claim, *United States v. Mexico General Claims Comm'n* (1926), 4 R.I.A.A. 60.
5. *Id.* at 61-2.
6. *Azinian v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award dated 1 Nov. 1999, 39 I.L.M. 537 (2000).
7. *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, 40 I.L.M. 36 (2001).
8. For further details, see R. Wisner, *Judicial Review of NAFTA Arbitration: Recent Canadian Decisions* in 20 INT'L LITG. Q., no. 2 (Fall 2004).
9. *S.D. Myers v. Canada*, Partial Award on Liability dated 13 Nov. 2000.
10. *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2 dated 10 Apr. 2001.
11. *S.D. Myers v. Canada*, Partial Award on Liability dated 13 Nov. 2000.
12. *Id.* at para. 263.
13. *Id.* at paras. 265-266.
14. *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2 dated 10 Apr. 2001, at paras. 109-118.
15. *Pope & Talbot Inc. v. Canada*, Award on Damages dated 31 May 2002, at para. 65.
16. The Annex reads as follows:

    > The Parties confirm their shared understanding that "customary international law" generally and as specifically referenced in Articles 10.5, 10.6, and Annex 10-C results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 10.5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.

17. *Pope & Talbot Inc. v. Canada*, Award on Damages dated 31 May 2002.
18. *Mondev Int'l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award dated 11 Oct. 2002, I.L.M. 85 (2003).
19. *ADF Group v. United States of America*, ICSID Case No. ARB(AF)/00/1, Award dated 9 Jan. 2003, 6 ICSID Reports 470 at paras. 185-186.
20. *Waste Management Inc. v. United Mexican States II*, Award dated 30 Apr. 2004 at para.98.
21. *Mondev Int'l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award dated 11 Oct. 2002, I.L.M. 85 (2003) at paras. 115-125; *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award dated 9 Jan. 2003, 6 ICSID Reports 470 at paras.180-181.
22. *ADF Group*, n. 19 *supra,* at 185-186.
23. *Waste Mgmt. Inc. v. United Mexican States II*, Award dated 30 Apr. 2004.
24. *Id.* at para. 9.
25. *International Thunderbird Gaming Corp. v. United Mexican States*, Award dated 26 Jan. 2006 at para. 147.
26. *Methanex v. United States*, Award dated 3 Aug. 2005 at Part IV, Ch. C, pp. 7-12.
27. *GAMI Invs. Inc. v. United Mexican States*, Award dated 15 Nov. 2004 at para. 103.
28. *Maffezini v. Spain*, ICSID Case No.ARB/97/7, Award dated 13 Nov. 2000, ICSID Review—F.I.L.J. (2001) at para. 85. *CME Czech Republic B.V. v. Czech Republic*, Partial Award dated 13 Sept. 2001.
29. *Genin v. Republic of Estonia*, Award dated 25 June 2001, 6 ICSID Reports 241.
30. *Saluka v. Czech Republic*, Award dated 17 Mar. 2006.
31. *Id.* at para. 295.
32. *Tecnicas Medioambentales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award dated 29 May 2003 (referred to as the "*Tecmed*" case").
33. May 23, 1969, 1155 U.N.T.S. 331 (entered into force 27 Jan. 1980).
34. *Compania de Aguas del Aconquija S.A. & Vivendi Universal S.A. v. Argentine Republic*, Award dated 20 Aug. 2007.
35. *Azurix v. Argentina*, ICSID Case No. ARB/01/12, Final Award dated 14 July 2006.
36. *Compania de Aguas del Aconquija S.A. & Vivendi Universal S.A. v. Argentine Republic*, Award dated 20 Aug. 2007 at 202.
37. *Occidental Exploration & Prod. Co. v. Republic of Ecuador*, Final Award dated 1 July 2004.
38. *Id.* at para. 183. *See also LG&E Energy Corp. v. Argentine Republic*, Award dated 3 Oct. 2006, at paras. 131-138.
39. *Tecnicas Medioambentales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award dated 29 May 2003, at para. 154.
40. *Id.* at para. 154.
41. *MTD Equity v. Republic of Chile*, Decision of the Annulment Committee dated 21 Mar. 2007.
42. *Id.* at paras. 67-69.
43. *See Azurix v. Argentina*, ICSID Case No. ARB/01/12, Final Award dated 14 July 2006; *Compania de Aguas del Aconquija S.A. & Vivendi Universal S.A. v. Argentine Republic*, Award dated 20 Aug. 2007.
44. *See LG&E Energy Corp. v. Argentine Republic*, Award dated 3 Oct. 2006; *CMS Gas Transmission Co. v Argentina* (2005), ICSID Case No. ARB/01/8, Award dated 12 May 2005, *Enron v. Argentina,* ICSID Case No. ARB/01/3, Award dated 22 May 2007.
45. *See Occidental,* n. 37 *supra.*
46. *See MTD*, note 41 *supra.*
47. *See Eureko v. Poland*, Partial Award dated 19 Aug. 2005.
48. *See PSEG v. Turkey,* ICSID Case No. ARB/02/5, Award of 19 Jan. 2007.
49. *See Saluka*, note 30 *supra.*
50. *See Waste Management II*, note 20 *supra.*
51. *CMS Gas Transmission Co. v. Argentina* (2005), ICSID Case No. ARB/01/8, Award of 12 May 2005.
52. *Id.* at para. 284.

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Private Equity Investments in Argentina

By Juan Martín Arocena

I. Introduction: Venture Capital in Demand in Argentina and Throughout Latin America

In order to sustain the significant growth experienced in the last five years, Argentine companies need venture capital. More traditional funding sources are very limited for medium-sized and small Latin American companies and even more so for startups. Moreover, angel investors are very rare in the region.

In the last few years, an increasing number of Argentine companies have looked to private equity funds to solve their need for capital and resources. During that time, a fundamental shift occurred in the external flow picture in Argentina: official flows such as World Bank funds and foreign aid are no longer as important as they were ten years ago. Private flows made up of foreign direct investment, stocks, private non-bank, and commercial bank funds are currently almost four times higher than official flows to Argentina.

Still, although in the U.S. private equity totals $60 billion or .75% of GDP, in Latin America it reaches only $8 billion or .5% of GDP. In Latin America, entrepreneurs are usually the recipients of these funds, commonly through complex deals which investors find difficult to price in part due to the lack of quality information.

This article addresses the main legal concerns that the private equity funds typically have when investing in Argentina and gives an overview of how some of these concerns have been addressed. Although the article focuses on the legal hurdles and the mechanism used to reduce the exposure of private equity funds when investing in Argentina, the cultural concerns of the companies of the region are also examined to offer a more comprehensive analysis.

II. Structuring the Acquisition

A. Overview

Structuring the acquisition correctly is key to a successful private equity investment in Argentina. In particular, this means taking into account tax regulations and a potential litigation, as well as the problems of enforcing a foreign judgment in Argentina. Argentine courts have almost no experience in enforcing structural remedies and exit strategies such as puts or tag- or drag-along rights. Moreover, sometimes local corporate laws and regulations contradict certain typical provisions of a shareholders' agreement. Litigating in an Argentine court is cumbersome and it may take many years due to a complex process and the large number of appeals allowed by procedural law. In fact, many times the procedure is longer than the duration of a typical investment by a private equity group.

Although these hurdles may be sometimes avoided through arbitration, in our experience, sometimes local arbitrators do not have sufficient expertise and experience dealing with disputes over shareholders' rights in private equity transactions. For these reasons, it is essential to structure a private equity investment in an Argentine company properly in order to avoid litigating in an Argentine court.

B. Using U.S.-Style Transaction Documents in an Argentine Deal

Transaction documents used on a purely local deal would look very different from those used in an international or domestic-U.S. deal. Because Argentina has a civil law system, many of the issues addressed in great detail in a subscription or shareholders' agreement in the U.S. would generally not be reflected in an Argentine document for a purely local transaction. Many of the issues in these agreements are already governed by the Argentine commercial code and corporations law even if the parties do not contemplate them specifically in a transaction document. Nevertheless, in an international private equity deal, both parties generally retain local counsel with international experience who are very familiar with the structure of U.S. documents and the requirements of U.S. counsel.

In our experience, because Argentine family-owned businesses are generally the recipients, detailed representations, covenants and conditions typically used in U.S. private equity transactions have several benefits for U.S. investors acquiring an equity interest in an Argentine company. For example, they increase the probability that the due diligence effort will be effective since generalizations are easier to ignore than specifics.

In Part II.D.2.c below, we analyze several of the specific representations, covenants, conditions and indemnities that should be contemplated in an Argentine deal.

C. Due Diligence

1. Cultural Considerations

One of the greatest cultural differences generally arises when a family-owned Argentine company realizes that it has to be more transparent, open and accountable to outside investors, especially when that investor is a foreign private equity fund with much different rules, timetables and procedures. One of the first instances in which these differences appear is during the due diligence process, since it is often hard for an Argentine family-owned company to open completely its books, documents and affairs to outsiders.

Many times, Argentine family-owned businesses are also concerned about the lack of understanding that a foreign private equity fund might have as to how business is conducted in Argentina.

In this Part and in Part II.D., we analyze the two main stages in the acquisition process: the fact-finding or due diligence stage is discussed in Section II.C.2 and, in Part II.D, we address the second stage, that is, the stage dealing with the drafting, negotiation and formalization of documents.

2. The Due Diligence Process

Investors acquiring an interest in a family-owned Argentine company should carry out careful due diligence regarding the status of the Argentine company. The investigation should include examination of the information obtained from public registries, as well as the information provided by the selling shareholders. Investors should carefully focus on any tax or labor contingency and determine whether there are any acts or agreements granting *in rem* rights in or encumbrances on the assets of the company that are pending registration.

The matters to be analyzed in the due diligence process must cover several issues concerning the company, such as legal, tax and accounting aspects, including but not limited to the following:

- whether the minute books have been duly maintained;
- whether all assets and liabilities duly appear in the balance sheet;
- whether all assets (including real estate, trademarks, trade names, patents, and the like) are duly registered in the name of the company;
- whether the company is a party to contracts that lack a specific term (since they may be terminated by any party at any time);
- agreements containing any change-of-control clauses, non-competition or exclusivity provisions; and any agreement that, in view of the legal provisions or case law, may result in the other party's having a right to a claim for compensation upon its termination;
- lists of distributors, suppliers and clients; and
- lists of employees, specifying their salaries, termination rights and other fringe benefits and so forth.

D. Drafting the Transaction Documents

1. Term Sheets and Letters of Intent

A term sheet or letter of intent sets forth in detail the principal terms and conditions on which the investment will be made.

The terms and conditions will be influenced by the amount to be invested, the level of ownership the investment represents, the type of business the company operates, the company's financial situation, and the type of investment (e.g., made at the development stage, as a strategic investment in an ongoing business or as a recapitalization).

The most important issue to be addressed in the term sheet is determining the value of the company. Other important issues include the schedule of when the capital is to be invested and determining the nature of the investment (common stock, preferred stock, convertible debt, and the like).

Usually, letters of intent are not legally binding under Argentine law. However, they have the advantage of limiting the scope of debate in the negotiations. As in other cases, it is important to find a middle ground. If a letter of intent is more detailed, it consumes energy and time which could better be spent working on the definitive transaction documents. If it is not detailed enough, a party may construe that fact to mean that some points have been waived.

2. Main Transaction Documents

a. Overview

Once the terms and conditions have been negotiated by the parties, U.S. and local counsel will incorporate them into the transaction documents. The transaction documents will include both a securities purchase agreement and a shareholders' agreement, which regulates all aspects of the relationship among the company's shareholders. If registration rights are contemplated, they will either be incorporated in the shareholders' agreement or contained in a separate registration rights agreement.

b. Shareholders' Agreement

Set forth below is a description of the principal issues that will arise in negotiations with potential investors regarding the shareholders' agreement.

(1) Governance

Generally, private equity investments in Argentina are made in family-owned and -controlled companies. Investors will expect representation on the company's board of directors, typically at a level proportionate to their investment. By having one or more appropriate representatives on the board of directors, together with the veto rights referred to below, the investors will feel that they have the ability to influence the portfolio company's business and to protect their investment.

(2) Veto Rights of Minority Investors

Under Argentine law minority shareholders are not well protected. Thus, it is key for minority investors to negotiate approval rights regarding matters that are important to the capitalization, financing and management

of the Argentine company. Veto rights in favor of a minority investor are created either by explicitly granting an investor these rights in the organizational documents of the portfolio company (including, as described in Part V.C, by creating a separate class of securities held only by the investors and requiring the approval of holders of that class of securities, voting as a separate class), or by requiring the approval of a supermajority of the stockholders.

The nature of the Argentine portfolio company will also have an effect: generally, the more established the company, the fewer of these issues require investor approval. Issues requiring approval by a minority investor are often divided between those actions that require approval at the level of the board of directors and those actions requiring shareholder approval.

c. Stock Purchase Agreement

(1) Overview

The stock purchase agreement will, in addition to containing the terms regarding the purchase of the shares, include extensive and detailed representations and warranties concerning the business, assets, liabilities and financial condition of the company and its subsidiaries, their compliance with all applicable laws and regulations, and their possession of all required governmental permits, authorizations and licenses, and may also include representations about the selling shareholders. The stock purchase agreement will also include covenants and a broad indemnification in favor of the investors for any damages arising from any breach by the company or the selling shareholders of any representations or warranty or covenant. The stock purchase agreement will also generally include numerous disclosure schedules that require the company and its counsel to furnish detailed, itemized information.

The representations, conditions and indemnities that in most cases should be included in the Stock Purchase Agreement for an Argentine private equity deal are addressed in the remainder of this Part II.D.2.c below.

(2) Representations

For several reasons discussed below, with respect to an investment in an Argentine portfolio company, it is especially important for the representations to be specific since they will favor the disclosure of potentially problematic issues. Nevertheless, an investor should bear in mind that for an Argentine family-owned business, an investor who insists on many representations can be a nightmare. Thus investors should focus on those that are important to the specific business of the company.

- Detailed representations define what the concept of materiality means in the agreement. For example, if the company represents that all leases over $50,000 a year are listed in Exhibit A, that may be viewed as the cutoff level of materiality for leases.
- Defined representations also provide a number of triggers that can be used as closing conditions.
- Detailed representations may give an investor more leverage in adjusting the price at closing.
- Specificity increases the probability of effective due diligence by the selling shareholder since generalizations are easier to ignore than specifics.
- Specific lists provide investors with a comprehensive idea of the documents they or their representatives should examine before investing.

Representations can be more or less favorable to a buyer depending on how they are drafted. One common method of watering down a representation is to add a reference to knowledge or materiality. If knowledge is used as a qualifier by the Argentine selling shareholder, the document should state whose knowledge counts.

(3) Survival of Representations

The strength of representations ultimately depends on the extent to which they survive the closing.

An Argentine company or selling shareholder may be willing to represent everything as long as it does not survive the closing. On the other hand, investors and their counsel will want to match as much as possible the term of the local statute of limitations. A common middle-ground solution is to have the representations survive, but only for a short period. Certain representations, specifically those regarding taxes and labor matters which involve third-party claims and have longer periods under the local statute of limitations, should be carved out and given a longer survival period.

On public company deals, unless there is a large controlling interest, it is unusual to have representations survive the closing.

(4) Conditions to Closing

Conditions can be an important pressure point when investing in an Argentine portfolio company. One important condition stipulates that the representations are true as of the closing date and that the Argentine managing shareholder is in compliance with all the covenants made by that shareholder. This "bring-down" provision serves several purposes for the investors since it motivates the Argentine managing shareholder to operate diligently his company. Otherwise, the company may breach a condition, and the investor will be released from any obligation to close.

With favorable representations, particularly a "material adverse change" (or "MAC") clause, and a bring-down representation set forth in the transaction documents, an investor maximizes the chance it will have an out should it find substantial problems through later pre-closing due diligence. Even if the investor does not

close the deal, a MAC clause will provide leverage for renegotiation of the price, especially in a country where unforeseen economic crises are common.

Due to the requirements of the Argentine Antitrust Act (see Part VIII below), an "antitrust out" is another important condition. Moreover, investors should also be protected by a condition triggered if the Argentine antitrust review process remains open as of the closing date.

A consents condition requiring an Argentine shareholder to secure all third-party consents that are necessary to allow the transfer of assets and contracts is also important in an Argentine deal. Valuable agreements may require the counterparty's consent if they are to be assigned or may have a "change of control" provision. These provisions are very important since often the Argentine counterparty—once it realizes its consent is valuable—asks for a renegotiation of its terms.

Requiring an opinion of the Argentine company's local in-house counsel will cause counsel to do a more thorough job of diligence. Local counsel should also indicate that, to his or her knowledge, he or she is not aware of any material misstatements or omissions in the transaction documents.

(5) Indemnities

Argentine sellers are generally reluctant to indemnify investors. This is especially true in the case of family-owned Argentine companies. Thus, it is important for investors to inform their Argentine counterparts early on that assuming a certain amount of undisclosed liabilities in their valuation analysis will result in a lower up-front purchase price. With a good indemnity, the investor is able to value the Argentine target on the basis that the latter does not have undisclosed liabilities.

On the other hand, indemnities will not be very valuable if they need to be litigated, especially in Argentina since courts do not have much experience in this area and litigation usually takes a very long time, generally, longer than the expected term of the investment. However, the extent and amount of the indemnity may always be negotiated with local managers against other dues or benefits when exiting the investment.

The time period during which an indemnity claim can be made should be determined by the extent to which the representations survive the closing. It is useful to provide for a "basket" in order to bridge the gap between the investor and the Argentine selling shareholder(s). A "basket" will release the seller from relatively minor damages, while protecting the investor from major problems.

An indemnity will provide little protection unless the Argentine indemnifying party has the ability to pay the indemnified claim. In certain cases investors should seek to complement the indemnity with an escrow or eventually a setoff against any deferred payments due.

III. Providing the Right Incentive for Management; Use of Options

In order to provide incentives to management, investors typically rely on stock options. However, stock option plans have certain regulatory restrictions in Argentina. Argentine corporate law does not allow companies to issue treasury stock. Thus, an Argentine company cannot, in principle, grant options to buy its shares. If a non-Argentine holding structure is used, as is recommended below in Part V.E.4, options may be granted with respect to the stock of the non-Argentine holding.

Another common alternative allowed by Argentine law is to grant "phantom" options. These are not real options in a technical sense. Nevertheless, they may serve the same purpose. A "phantom" option is a bonus that entitles the recipient to receive in cash an amount equivalent to the value of the company's stock at two different times.

IV. Exchange Controls

During the 1990s, Argentina enjoyed for the first time a regime of exchange-controls freedom. In fact, local and foreign banks located in the country closed their exchange departments in most cases.

Following the major economic crisis of 2001, certain regulations re-imposed significant exchange-control measures together with restrictions on the transfer of bank deposits locally known as "*corralito.*" Thereafter several different, and sometimes contradictory, exchange-control regulations were issued, until in February 2002 a new regime was enacted, establishing exchange-control requirements for certain transactions, such as the export of certain goods or services. On the other hand temporary withholding measures ("*Encaje*") were set forth by the Argentine Central Bank for certain cash inflows of foreign currencies made by foreign organizations or individuals. Pursuant to the *Encaje* measures, thirty percent of certain cash inflows are required to be temporarily withheld for up to a year by the Argentine Central Bank. Moreover, following the 2001 crisis certain regulations regarding exchange-control crimes and penalties were again put in effect by the Argentine Central Bank.

Although the current Argentine exchange regime is quite cumbersome—and, thus, each transaction should be analyzed on a case-by-case basis—an acquisition and subscription of shares of more than ten per cent of the stated capital of an Argentine portfolio company by non-Argentine individuals are not subject to the temporary withholdings (*Encaje*) requirement. Likewise, a payment of dividends and remittance of capital following the sale of shares of an Argentine portfolio company are not currently subject to exchange-control restrictions.

V. Exit Strategies

A. Overview

The relative illiquidity of an Argentine family-owned company's shares purchased by an investor generally represents one of the most significant risks in any private equity investment. Only in very few occasions has a private equity fund been able to exit through an initial public offering (IPO). Accordingly, the investor will insist upon negotiating another acceptable exit strategy at the outset of the investment.

In this Part we examine the main issues under Argentine law in regard to the most relevant exit strategies used by private equity investors in private equity deals in Argentina.

Generally, as a result of less mature securities markets, an exit strategy in Argentina is more likely to involve a strategic sale than it would in the U.S.

B. Including the Exit Strategies in the Articles of Incorporation of the Argentine Company

In connection with an investment in an Argentine portfolio company, it is advisable that most exit strategies be reflected both in the company's articles of incorporation and in the shareholders' agreement. Under Argentine law, contractual provisions are valid and enforceable between the parties to the agreement. The provisions set forth in the articles of incorporation, on the other hand, are not only valid and enforceable vis-à-vis the shareholders but also vis-à-vis third parties. Thus, the general rule is to include in the articles of incorporation all provisions that shareholders want to be valid and enforceable vis-à-vis third parties (i.e., creditors, future shareholders, and the like). The most significant matters this would include involve voting rights, the structure of the board of directors, and the voting requirements for the board of directors and general and special shareholders' meetings. Investors should be aware that, once a certain right is set forth in the articles of incorporation, it will be difficult to change since amending the articles of incorporation requires special majorities. Moreover, articles of incorporation are public documents and may be reviewed by any third party. We will analyze below some of the amendments typically made to a company's articles of incorporation on a private equity deal.

C. Classes of Stock

1. Need for Different Classes of Stock

To reflect many of the provisions of the transaction documents in a company's articles of incorporation, classes of stock need generally be created. Argentine corporate law allows for the creation of different classes of stock. Although all securities in each class must have the same rights, different classes of stock may have different rights. Thus, some special rights may be granted to one or more classes and not to others.

2. Preferential Voting Rights

Argentine corporate law allows private companies to have one or more classes of stock with the right to have up to five votes per share, while other classes have only one vote per share. If the articles of incorporation already have classes with different voting rights in place before the shares of the company are listed, the Argentine Securities Commission (CNV) and the Buenos Aires Stock Exchange will also allow these provisions. Once the shares are publicly traded or listed, however, it is not possible to create a class with more than one vote per share.

Different voting rights may allow a controlling shareholder to sell part of its equity interest without releasing control of the company. Preferential voting rights may also be used to increase control by minority shareholders in certain cases.

3. Changes of Class

When classes of stock are set forth in the articles of incorporation of the Argentine portfolio company, the transfer of stock between parties implies the transfer of all the rights of the shares of that class. If an investor wants to avoid this transfer, the articles of incorporation must provide that certain transfers of one or more classes of stock will automatically cause the stock to change class (and thus change the rights attached to that certain class).

4. Different Classes; Different Rights

The articles of incorporation of Argentine private companies can also contemplate that classes of stock will have the right to appoint a different number of directors. For instance, Class A may have the right to appoint five directors, with Class B able to appoint only one. Once the shares of a company are publicly traded, CNV regulations provide that the number of directors that each class of shares may appoint must be proportionate to the equity interest represented by that class.

5. Other Privileges

A certain class may also be granted certain supermajority rights and even veto power for certain decisions. These provisions are used to protect the rights of minority shareholders.

6. Dismantling the Mechanism

Any preferential rights granted in the articles of incorporation of an Argentine corporation to a certain class remain with that class, even if only one share of that certain class remains. Thus, it is important to provide in the articles of incorporation that the privileges granted to a certain class will be forfeited once that class represents less than a certain percentage of the equity.

D. Transfer Restrictions

This Part examines the validity and enforceability of the more standard transfer restrictions under Argentine law.

1. Right of First Refusal

Although it is common in Argentine private equity deals for investors to have a right of first offer or a right of first refusal, these rights generally favor local management more than the private equity fund since it is unlikely that a fund would exercise its right of first refusal since it is a portfolio investor. Under this provision a member of the Argentine group of shareholders who wants to sell shares to a third party must offer his or her securities first to the group of investors on the same terms and conditions as contained in the third-party offer to buy its securities.

Under Argentine law the portfolio company may not have a right of first refusal, nor may it be subject to first refusal rights (preemptive rights) prior to issuing any new securities.

Among the shareholders, a right of first refusal or of first offer is valid and binding under Argentine law.

2. Share Retention Agreements

A share retention agreement prevents a certain shareholder from selling his or her securities in the company until the agreement expires. Under Argentine law share retention agreements are valid for limited periods: generally, courts provide that they may not be longer than two years. Limited share retentions (e.g., containing a prohibition against selling to a certain person or to competitors) are valid and not subject to a time limit, provided that they do not imply an absolute restriction to sell the shares.

E. Exit Mechanisms

1. Overview

The exit procedure set forth in the shareholders' agreement will depend on, among other factors, the size of the company and its business, as well as market conditions. The shareholders' agreement will usually anticipate that the company will be taken public through an IPO. However, for different reasons indicated below, an IPO may not be possible at the time the investor wants to exit the company.

The following are some of the exit strategies used on Argentine private equity deals.

2. Sales to Third Parties

a. "Tag-Along" Rights

A tag-along right obligates a local selling shareholder to offer to sell the securities held by the private equity fund on the same terms and conditions as those agreed to by the local selling shareholder and the party purchasing the securities. Thus, tag-along rights allow the fund to exit the investment if either another fund or the local shareholders find a buyer and want to exit.

Likewise, a tag-along provision discourages competition among shareholders in selling their shares to a potential buyer. Tag-along rights generally apply only to sales of a majority of the outstanding shares of the company. In such a case, the tag-along right prevents a third party from offering to purchase from the majority shareholders at a premium price only that number of shares sufficient to control the company.

Certain restrictions in the valuation of the shares may apply under Argentine law.

b. "Drag-Along" Rights

Under a drag-along provision, the fund is entitled to force the managing local shareholders to sell their securities on the same terms and conditions as those contained in the third-party offer made to the fund. Drag-along rights allow majority shareholders to force uncooperative minority shareholders to sell their shares as part of the majority's transaction.

The key issue is the valuation of the shares being sold. In an Argentine private equity deal, valuation clauses should be carefully drafted in order to avoid potential problems if litigated in Argentina.

3. Sales Among Shareholders of the Company

a. "Puts"

A "put" entitles the fund to require another shareholder or the portfolio company to purchase the stock held in the company by the fund. One typical problem with this exit strategy is that capital is generally not available for these cases. Moreover, Argentine companies may only redeem stock in the limited circumstances described below.

If the shares of the Argentine portfolio company are not publicly traded, put provisions often indicate that the shares will be valued based on a certain formula. This formula generally provides that the investor will receive the purchase price that it paid plus a premium. Pursuant to Argentine law, the price contemplated in the put may not be "notably different" from the "market" price of the shares sold under the put at the time of their sale. If the price is notably different, the put provision may be declared void when challenged before an Argentine court.

Argentine companies may only redeem their shares subject to the following requirements and limitations:

- Shares may only be redeemed in connection with a reduction in capital decided by a majority vote of an extraordinary shareholders' meeting.
- Redemptions are to be made proportionately with respect to all shares of the portfolio company. Thus, no distinctions can be made between shareholders in the case of redemptions. The only possible distinction that could be made is between common and preferred shareholders.

- A portfolio company may redeem fully paid shares of its capital stock only with retained earnings or available reserves, upon a determination of the board that such repurchase is necessary in order to avoid severe consequences to the company. The determination must be explained at the next annual meeting of shareholders.
- In the event of redemption, the portfolio company is required to resell or cancel the shares repurchased within one year and must give shareholders preemptive rights to purchase such shares.
- Any redeemed shares, while being held by a company, will not be considered in the determination of a required quorum or majority vote, and the company will not be entitled to exercise any rights related to those shares.

b. "Calls"

A "call" gives a shareholder the right to buy shares of the company from another shareholder by obligating the other shareholder to sell its securities to the former. The same comments regarding valuation and validity that we made for the put option are applicable to this case.

4. Strategic Sales

In Argentina, an exit strategy is likely to involve a strategic sale as a result of a less mature and liquid security market.

Many controlling Argentine shareholders are family members who have historically opposed selling any equity in their company and who are, as a rule, unwilling to surrender control. As a result, private equity investments in Argentina involve the acquisition of a non-controlling equity interest in the company more often than is common in the United States.

5. Public Sale of the Shares in Argentina: Registration Rights

Since most of the private equity investments in Argentina are not exited through IPOs, registration rights are not particularly helpful.

Registration rights give the investor a right to have its securities registered under the securities laws of Argentina and thus make those securities freely tradeable to the public. "Piggy-back" registration rights give the shareholders the right to register their securities if the company registers securities. "Demand" registration rights, on the other hand, require that the company initiate and follow through with a registered offering and include offering shares held by the investor making the demand.

As mentioned above, issuing stock is not a common exit strategy in Argentina. While the capitalization of U.S. stock markets is in the trillions, the Argentine Merval has a capitalization of only $120 billion. Argentine securities markets are dominated by government bonds. The equity markets offer only a small number of highly liquid shares. There is a second tier with limited liquidity, and many listings with no liquidity at all. Moreover, Argentine stock market capitalizations as a percentage of GDP are very low when compared to OECD countries or Asia.

6. Liquidation of the Company's Assets

As an equity holder, an investor that holds the stock of an Argentine company will not receive any money back from a liquidation of the company until all debt holders have been paid in full.

Upon liquidation of an Argentine company, one or more liquidators are appointed to wind up its affairs. In the event of liquidation, the assets of the Argentine portfolio company are applied to satisfy its debts and liabilities. Any remaining amounts are distributed to the shareholders in proportion to their respective shareholdings, subject only to preferential rights of any outstanding preferred shares. Other than such preferential rights, no other "liquidation preferences" may be established under Argentine law.

VI. Choice of Law and Jurisdiction

A. Choice of Law

When structuring a transaction, investors and their counsel may generally elect to have the transaction documents governed by their own laws and jurisdiction. Some Latin American countries (e.g., Uruguay) provide that agreements with effects in the host country must be governed by local law. Others (e.g., Brazil) provide that, if the agreement is executed in that country, it must be governed by local law. Argentine law generally permits parties to a contract to select the law that will govern their agreements as long as there is some connection to the system of law that is chosen. Nevertheless, the choice of foreign law will only be valid to the extent that it does not contravene Argentine international public policy. Typical public policy laws include criminal, tax, labor and bankruptcy laws, and matters concerning religion, tolerance and morality. Pursuant to Argentina's conflicts-of-law rules, if Argentine international public policy is deemed applicable, an Argentine court will substitute the applicable rule of Argentine law for a foreign rule. Furthermore, if an act is invalid under foreign law, an Argentine court may apply Argentine law if it is more favorable to the validity of such act.

Rights associated with real estate (such as in rem rights), are all governed exclusively by Argentine law. The same principles apply with respect to movable property permanently located in Argentina.

B. Jurisdiction

Argentine law allows parties to a contract to choose a jurisdiction other than Argentina for the settlement of any disputes arising under a contract, as long as there is a

contact with such jurisdiction and the dispute relates to monetary rights.

If the parties to an agreement have not elected a forum, Argentine courts will have jurisdiction whenever (i) the defendant is domiciled in Argentina, (ii) the place for performance of any of the obligations is located in Argentina, or (iii) Argentine courts have been chosen as the applicable forum (subject to certain restrictions).

Argentine courts are vested with exclusive jurisdiction to hear all insolvency proceedings relating to debtors domiciled in Argentina. With respect to debtors domiciled abroad, Argentine courts will have jurisdiction only to the extent that the debtor has assets in Argentina, in which case the insolvency proceedings will cover only those assets.

C. Enforcement of Foreign Judgments

If an international treaty for the enforcement of foreign judgments has been entered into between a country and Argentina, the rules of that treaty will govern the enforcement of foreign judgments in Argentina. In the absence of a treaty, the National Code of Civil and Commercial Procedure (CPCC) will be applicable if the defendant is domiciled in the City of Buenos Aires or if the subject matter is heard by a federal court.

Subject to certain requirements, Argentine courts will enforce foreign judgments that resolve disputes and determine the rights and obligations of the parties to an agreement. Section 517 of the CPCC sets forth the following requirements that a foreign judgment must meet in order to be enforced without further discussion of its merits:

(1) the judgment must have been issued by a court considered competent by the Argentine conflicts-of-law principles regarding jurisdiction, been final in the jurisdiction where it was rendered, and resulted from a personal or an in-rem action. If the judgment resulted from an in-rem action, personal property must have been transferred to Argentina during or after the prosecution of the foreign action;

(2) the defendant must have been personally served with the summons and, in accordance with due process of law, given an opportunity to defend against the foreign action;

(3) the judgment must have been valid in the jurisdiction where it was rendered, and its authenticity must be established in accordance with the requirements of Argentine law;

(4) the judgment must not violate the principles of public policy of Argentine law; and

(5) the judgment must not be contrary to a prior or simultaneous judgment of an Argentine court.

Reciprocity is not required for an Argentine court to enforce a foreign judgment. A foreign judgment obtained in default will only be enforced if the defendant was personally served with the summons and was given an opportunity to defend against the foreign action in accordance with due process of law.

D. Procedures Relating to Enforcement of a Foreign Judgment

Enforcing a foreign judgment in Argentina may necessitate a complicated procedure. To enforce a foreign judgment in Argentina, a legalized copy of the judgment must be filed with the Argentine court, and the petitioner must file a statement evidencing that each of the requirements mentioned in the preceding Part has been fulfilled. All documents (which must be originals or notarized copies) submitted to the court must be authenticated by the Argentine consulate with jurisdiction over the country where the documents were issued. If such country has ratified the 1961 Hague Convention, an *Apostille* as contemplated by that convention may be substituted for authentication by the Argentine consulate. All documents in a language other than Spanish must be translated into Spanish by a certified Argentine translator.

The amounts expressed in foreign judgments need not be converted to local currency solely because recognition of a foreign judgment is sought.

A plaintiff seeking enforcement of a foreign judgment is entitled to request and obtain protective remedies from a local court pending the decision. Protective remedies may be granted at the commencement of the proceedings or thereafter, and may consist of the attachment of assets or a general or specific injunction. In order to grant a remedy, a local court requires the petitioner to post a bond to cover eventual costs, expenses and/or legal fees.

Once all formalities have been complied with, and the foreign judgment meets local requirements for enforcement, the local court is not entitled to re-open the case heard by a foreign court.

E. Immunity

Certain assets are unavailable to satisfy judgments obtained or determined to be enforceable in Argentina. Such assets include (i) certain public property belonging to the Argentine national, provincial and municipal governments (i.e., property in the public domain in accordance with Sections 2337 and 2340 of the Civil Code); (ii) assets backing the Argentine monetary base pursuant to the Convertibility Law; (iii) assets that are essential for the direct provision of public services; and (iv) certain personal assets considered of elemental necessity.

F. Enforcement Expenses and Legal Fees

Payment of a court tax is a condition for instituting proceedings to obtain recognition of a foreign judgment for the payment of money. The current tax in the federal

courts of Argentina or the courts of the City of Buenos Aires is three percent of the stated amount of any foreign judgment sought to be enforced, including accrued interest.

The amount of this tax is added to the amount contemplated in the foreign judgment if enforcement is granted by the Argentine court. A successful plaintiff may recover from the defendant both the amounts stated in the judgment and any amounts paid as legal fees, other costs and expenses and, if applicable, court taxes. Subject to certain exceptions, Argentine law allows a successful plaintiff to recover attorney's fees, costs and expenses from the defeated party.

Upon filing a claim, a foreign plaintiff who does not have either a domicile or real estate in Argentina may be required to post a bond or guarantee to cover fees and expenses incurred by the defendant in connection with the defense of the action, as a condition to further pursuance of the action.

G. Arbitration

Foreign arbitral awards are enforced in Argentina but are subject to the same requirements applicable to the enforcement of foreign judgments mentioned above. If these requirements are met, an Argentine court will enforce arbitral awards rendered outside Argentina. Argentina is a party to the U.N. Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958, known as the New York Convention.

VII. Regulations Relating to Foreign Investment in Argentina

A. Overview

Since 1989 foreign investors are entitled to the same rights and subject to the same obligations as domestic investors. The Foreign Investment Act of September 1993 resulted in transparency and the repeal of procedural requirements that had served to limit foreign participation under the former law. Foreigners are now eligible to invest in any economic sector in Argentina and generally without obtaining prior approval and without worry over the availability of their earnings or assets.

This Part VII examines the regulatory issues related to foreign investment in Argentina.

B. Law Governing Foreign Investments

Foreign investments are governed by Argentine Foreign Investments Law 21,382, enacted in 1976, which has subsequently been the subject of considerable amendment with a view to liberalizing the regime applicable thereto.

The law states, as a general principle, that foreign investors investing in economic activities in Argentina enjoy the same status and have the same rights that the Argentine Constitution affords local investors. Both are entitled to select any legal organization permitted by law and to have free access to domestic and international financing. Furthermore, foreign investors are subject to the same procedures as local investors with respect to those activities which require government licenses, such as banking and insurance.

C. Investment Protection and Promotion

During 1989, Argentina entered into the 1958 treaty signed with the United States regarding the Overseas Private Investment Corporation (OPIC), which is an agency of the U.S. government that provides insurance to U.S. investments in developing countries. In October 1990, Argentina became a member of the Multilateral Investment Guaranty Agency (MIGA), sponsored by the World Bank, which provides insurance coverage for foreign investments made by persons or legal entities established in member countries.

These agencies insure investments against political risks, such as the availability and right to transfer foreign currency, expropriations and similar measures, breach of contract by the government of the host country, and war and civil unrest, among other risks. Both agencies require the prior approval of the lawfulness of the investment and insurance coverage by the government of the host country.

In addition, in recent years, Argentina has signed treaties for the promotion and protection of foreign investments with a number of countries, including the U.S., Germany, Switzerland, Italy, the U.K., Belgium, Japan, Canada, France, Chile, Spain, Sweden, Austria, Holland, Denmark, and China.

VIII. Compliance with the Antitrust Laws

A. Control of Mergers and Acquisitions

The Argentine Competition Act provides that transactions that may within its ambit include projects involving an economic concentration of undertakings. The Act has defined "economic concentration" as those transactions affecting on a lasting basis the control structure of the undertakings concerned through the merger of companies, the transfer of going concerns, the purchase of stock or other equity interests, or any other agreement transferring assets or vesting the decision-making power of the relevant company. The Competition Act has adopted a broad definition of the transactions included under its umbrella.

B. Triggering Event and Threshold

The Competition Act, based on the annual sales volume, provides a threshold for jurisdiction. It provides that notice of the transaction must be given when the aggregate sales volume of all affected companies within Argentina for the last fiscal year exceeds ARS $200 million.[1]

For purposes of the calculation of the sales volume of the affected company, the sales volume of any controlled, controlling and/or related companies must be taken into account in addition to that of the company actually involved. The total sales volume is calculated as the amount resulting from the company's sale of products and/or services, less any discount on sales, the value added tax (VAT) and any other taxes directly related to the sales volume.

C. Relevant Authority

The Competition Tribunal or *Tribunal de Defensa de la Competencia* (TDC) is the Argentine competition authority. The TDC operates under the authority of the Ministry of Economy and Public Works and Services. In addition, the Competition Act has granted the TDC exclusive authority to enforce the antitrust law within the sphere of public administration. The TDC has broad powers, inter alia, to demand reports from any involved parties, hold hearings or, if it deems necessary, issue a summons compelling attendance at public hearings, conduct a review of books and documents, or trace the origin and costs of raw materials and other goods. However, the TDC must obtain a judicial warrant to conduct any search of premises for the purpose of any inspection (unless it is conducted with the consent of the occupants of the premises) or to impose injunctive measures. The TDC is composed of six members and a chairperson, who are recommended by an ad-hoc committee and appointed by the government for a term of six years.

D. Exceptions to the Notification Requirement

The following transactions are not subject to the notification requirement:

(1) the acquisition of companies in which the purchaser already owns over fifty percent of the stock;

(2) the purchase of bonds, debentures, non-voting stock or debt securities;

(3) the acquisition of one sole company by one sole foreign company which owns no prior assets or shares of other companies in Argentina; and

(4) the acquisition of wound-up companies (companies that recorded no activity in the country during the previous year).

(5) A transaction of economic concentration in which neither the transaction amount nor the value of the assets located in the Argentine Republic that are absorbed, acquired, transferred or controlled exceeds ARS $20,000,000 unless any of the parties was involved in one or more transactions of economic concentration in the same relevant market in an amount exceeding ARS $20,000,000 in the prior twelve months or ARS $60,000,000 in the prior thirty-six months.

E. Notification Requirement

The Competition Act changed a voluntary notification regime into a mandatory one. Failure to notify may give rise to the imposition of fines amounting to up to ARS $150,000,000. Moreover, fines of ARS $1,000,000 may be imposed per day of delay if the parties fail to notify following the expiration of the notice period. (See the discussion of procedure and time limits below.)

Any project or transaction involving an economic concentration of undertakings meeting the annual sales volume thresholds described above must be notified to the TDC prior to completion or within one week after execution of the agreement or the acquisition of the controlling interest, whichever occurs first. In the case of tender offers, filings must be made within seven days after publication of the bid submitted to the Argentine Securities Exchange Commission (*Comisión Nacional de Valores*).

Notification does not entail suspension of the transaction. Nevertheless, the transaction will be subject to a final decision by the TDC, which may order divestiture, the cessation of control or the imposition of other conditions. A transaction will only be deemed consummated, i.e., effective among the parties and vis-à-vis third parties, when authorized by the TDC.

F. Procedure

There are three official forms of affidavits for notifying the TDC, and they must be completed in Spanish.

The information required in the first and the second form concerns the parties, their annual sales volume and business sectors, main terms of the transaction, ownership, control provisions and detailed market information.

The second form must be filed if required by the TDC and provides more specifics regarding the information provided on the first form and gives further details on the market in which the transaction is occurring. To expedite the approval procedure, the parties may file both forms together. All pertinent documents must be attached to the affidavit. Notifications must be complete.

A third form must be filed only if the TDC decides that it needs more information. The content of the third form varies on a case-by-case basis.

Although, notifications are public the parties may request the TDC to treat all or part of a notification as confidential. Once the TDC has reached a final decision, its report (and not the information filed by the parties) becomes publicly available.

Misrepresentations in the information provided to the TDC may subject a party to criminal penalties.

G. Guidance Procedure

The Competition Act has introduced a guidance procedure so that the undertakings concerned may, prior to

notification, consult with the TDC in regard to whether the thresholds are satisfied. Generally, the criterion is to approve horizontal combinations that improve productive efficiency and to prevent or otherwise subject to limitations any horizontal mergers that simply increase market power—for example, through price reduction commitments or a divestment of assets, and the like.

With regard to vertical mergers, the criterion is to prevent the new economic unit from extending its market power to other participants (e.g., by increasing costs for its competitors). Finally, as to mergers among unrelated companies resulting in the creation of conglomerates, the goal is to prevent the use of common entrepreneurial policies and the resulting elimination of prospective competitors. In all other cases, one must await the further developments in TDC's case law.

H. Time Limits

The transaction is deemed approved if the TDC does not issue a decision within forty-five business days after the filing of the affidavit. Even if a transaction is not notified, the TDC may investigate it on its own initiative. The TDC may order a transaction to be notified at any time within five years following the closing.

If the TDC requires additional information or if it so decides, based on a well-grounded basis, the 45-business-day period will be interrupted and will start running again when the additional information is provided.

I. Final Decision

The TDC may decide to:

- Approve the transaction;
- Approve the transaction subject to conditions that are favorable to economic and social progress such that they outweigh the negative effects on competition; or
- Declare the transaction unlawful.

Third parties may file a claim before the TDC. If the claim is dismissed, they may appeal before the *Cámara Civil y Comercial Federal*, which is an appellate court. In that case, the third party will be able to gain access to nonconfidential information in the file.

J. Substantive Test

The substantive test for clearance is whether the purpose or effect of a qualifying transaction (that is, one which meets the thresholds) is or may be to decrease, restrict or distort competition and whether its end result may be a detriment to the general economic interest. If the purpose or effect of the transaction and its end result are such, then the transaction will be prohibited. This test is set out in the Competition Act and must be used by the TDC.

The analysis by the TDC must be made strictly on competition grounds although the TDC is expressly allowed to consult with the relevant consumer associations and to consider the international competitiveness of the "national" industry.

K. Penalties

The TDC may order a party to cease any prohibited conduct and may impose a fine, which may range between ARS $10,000 and ARS $150 million. Any director, manager, administrator, member of the audit committee, as well as any agent or other legal representative who, due to his or her action or inaction has contributed to the violation is jointly liable for the payment of any fines.

In respect of any consummated acts in violation of the Competition Act, the TDC may demand from the competent court in the case that the defaulting company be dissolved, wound up, de-merged or broken up.

L. Appeals

The TDC's decision may be challenged before the *Cámara Nacional Civil y Comercial Federal,* which is a court with federal jurisdiction, within fifteen business days after it is issued.

IX. U.S. and Argentinean Antitrust Law Compared

The U.S. Sherman and Clayton Act and the Argentine Competition Act, have, among others, the following similarities and differences.

(a) Similarities

1. *Pre-notification*. Both Acts require the parties to give the relevant regulatory body pre-notification of certain mergers and acquisitions.
2. *Exceptions*. The exceptions to the obligation to give prenotification of a merger are similar in both Acts although the U.S. Act contains more exceptions than the Argentine Competition Act.
3. *Guidelines*. The TDC has established the same guidelines used by the U.S. Department of Justice and the U.S. Federal Trade Commission for horizontal mergers.

(b) Differences

U.S. law has established a much stricter control of mergers through "per se infractions," which provide that, when certain behaviors are proved (e.g., an agreement to establish a product price), it is unnecessary to continue the investigation to punish the parties because these behaviors are always harmful to the economy. In the Argentinean Act, on the other hand, it is imperative to analyze the overall effect of these behaviors in the economy and competition, since some transactions that may

initially appear anticompetitive may ultimately be found beneficial to the economy as a whole.

X. Basis for In-Personam Jurisdiction: Corporate Presence; Doing Business in Argentina

A usual question raised by non-Argentine companies is whether they might be subject to the Argentine Competition Act if they merge with or acquire a non-Argentine company, and one or both companies involved perform activities in Argentina.

A sure basis for in-personam jurisdiction of the Competition Act is the corporate presence in Argentina of any of the companies involved in the merger or acquisition, either through a subsidiary or a branch. That notwithstanding, case law may include in the future forms of "doing business" other than corporate presence (e.g., having a franchisor or distributor in Argentina) as leading to the jurisdiction of the Argentine Competition Act. In the meantime, mergers of non-Argentine companies that do not have a corporate presence in Argentina but that perform business activities in the country should be carefully analyzed on a case-by-case basis.

XI. Industry-Specific Rules

There are no special rules Competition Act for specific business sectors. However, the energy and telecoms sectors have industry-specific regulatory authorities: the *Ente Nacional Regulador de Energía* (ENRE), for the energy sector, and the *Comisión Nacional de Telecomunicaciones* (CNT), for the telecom sector.

One of the objectives of both the ENRE and CNT is ensuring that effective competition is maintained in these rapidly evolving markets.

The CNT has significant power over the players in this market, regulating access and interconnection to telecommunications networks. To this effect it can issue binding decisions. The CNT's objective when exercising these powers is to shape the market rules so as to enhance competition.

Notwithstanding these specific powers of the regulatory bodies, the Competition Act provides that the TDC has exclusive jurisdiction over the acts contemplated in that Act.

Endnote

1. That is, 200 million Argentine pesos (ARS).

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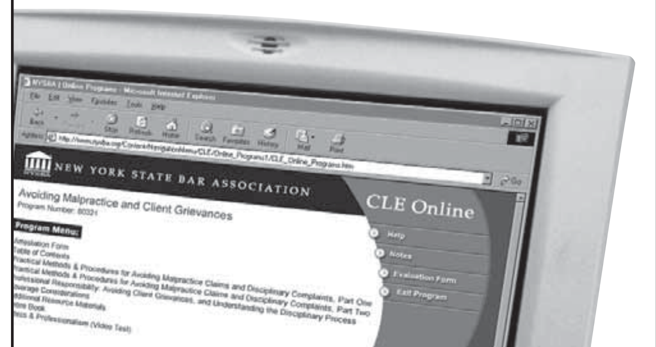

Termination of Distribution, Franchise and Agency Agreements in Peru

By Emil Ruppert Yañez

I. Introduction

Peruvian law does not provide specific regulations on distribution, franchise or agency agreements. Therefore, as a general rule, these kinds of agreements will be governed by the stipulations established by the parties, with certain restrictions established by law applicable to any agreement.

Like other types of agreements, these aspects on the distribution, franchise or agency agreements regulated by agreement of the parties will be complemented by the ground rules of contracts found in the Peruvian Civil Code, including provisions on termination.

Due to the fact that franchise agreements involve the licensing of patents and trademarks, some aspects of this kind of agreement are specifically regulated by the intellectual property laws. However, none of these laws provides for regulation of the termination of franchise agreements.

This article discusses the main rules of form, term, termination and jurisdiction which apply to distribution, franchise and agency agreements in Peru.

II. Form of Agreement

As a general rule, under Peruvian law an agreement does not need to be in writing to be enforceable, unless the law requires such formality in specific instances. Since distribution, franchise and agency agreements are not regulated specifically by Peruvian law, the general rule applies to them and therefore even oral agreements will have binding effect between the parties. However, since oral agreements are difficult to prove in court in the event of termination of the relationship, written agreements are recommended.

Notwithstanding the above, whenever franchise agreements include licensing of registered industrial property rights, such as invention patents or trademarks, the agreement must be written in order to be registered in the registry of the Bureau of Distinctive Symbols of the National Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI). Registration is necessary in order to allow the beneficiary, whether the legal owner or the licensee, to assert the rights against third parties and to allow the licensor and the licensee the freedom to transfer royalties in a convertible currency to foreign countries using the most favorable exchange rate.

III. Termination of Agreement

With respect to the manner of terminating contractual relationships in Peru, it will be necessary to take into consideration whether there is an event of default, as explained below.

A. Termination of the Agreement When There Is No Default

As long as there is not an event of default under the agreement, if the parties have agreed to an indeterminate duration or if the duration of the agreement has not been indicated at all, either of the parties may terminate the agreement by prior notice sent by notarial procedure at least thirty days in advance.

Once the thirty-day term has elapsed, the agreement will be deemed terminated by force of law, and neither of the parties may then require the other party to fulfill any obligation arising from the agreement.

It is a usual practice in franchise or distribution agreements to agree expressly to an indeterminate duration. In these cases, as well as in cases of fixed term agreements, it is customary to include clauses in the agreement establishing that either party will be authorized to terminate the agreement at any time without cause.

On the other hand, if the parties have agreed to a specific duration, without including a prior termination clause, and if there is no event of default, the only way to terminate the agreement earlier will be by means of a supplemental agreement between them to that effect.

B. Termination in the Event of Default

In the event that either of the parties fails to fulfill its obligations, the other party will have the possibility of terminating the agreement using any of the following procedures.

1. Article 1429

Under Article 1429 of the Peruvian Civil Code the party affected by the other party's failure to fulfill its obligations may require the defaulting party to fulfill such obligation by sending for such purpose a notarial letter demanding the fulfillment of the obligation. A notarial letter is a letter delivered by a notary public, who certifies delivery.

In such a letter the defaulting party is notified that the failure to fulfill incurred, and a specific period of time is

established in the letter with which the defaulting party is to comply. This term cannot be shorter than fifteen days.

Furthermore, this notice should indicate that, if the obligation has not been timely fulfilled, once the final period established therein has expired the agreement will be terminated. Thus, if the obligation has not been fulfilled within the final period established, the agreement is terminated by force of law, without the need to send any further notice.

It is important to state that the use of this method for the termination of the agreement is convenient only in cases where there is an interest in having the other party fulfill its obligations, since after the notary letter has been sent, if the other party fulfills the obligation, it will not be possible to invoke the termination of the agreement.

2. Article 1428

Article 1428 of the Peruvian Civil Code allows the non-defaulting party to file a legal action before the courts asking for the termination of the agreement. Unlike the termination method indicated in the item above, under this termination mechanism, once the party in default is served with the action, it will not be able to cure the default by fulfilling its obligation.

With respect to this method of termination, it is necessary to note that the principal drawback of this method of termination is the slowness of legal proceedings in Peruvian courts, where a process to terminate the agreement could take up to four years. Therefore, this procedure is more efficient if the parties have agreed to arbitration.

3. Specific Events of Default

In accordance with Article 1429 of the Peruvian Civil Code, the parties may include in the agreement specific events of default, in the event of which the agreement will be automatically terminated by force of law.

Once a party is in default, the agreement will be terminated by force of law, with the sole requirement that the innocent party notifies the defaulting party, indicating that it wants to make use of the termination clause.

IV. Dispute Settlement

Pursuant to the rules of the Peruvian Civil Code, the parties are free to agree on the law that will apply, as well the jurisdiction for the settlement of disputes. The sole restriction is that foreign rules chosen are not to be inconsistent with international public order or good customs.

The parties are also free to agree on arbitration, which may be under the auspices of a national or international arbitration tribunal, which also establishes the rules of the arbitral proceeding.

To the extent that the parties have not provided otherwise by agreement, it will be presumed that Peruvian law governs and that disputes will be settled before the competent judges and courts, according to the domicile of the defendant.

Furthermore, in the absence of any specific agreement, in international transactions in which there are various jurisdictions involved, it will be necessary to apply the rules of private international law established in the Peruvian Civil Code in order to determine the law and the jurisdiction that will apply in each case.

Pursuant to the aforementioned rules of private international law, in business relationships such as those generated by distribution, franchise or agency agreements, if obligations are going to be performed in Peruvian territory, the competent jurisdiction will be Peru. There are other rules regarding this matter, but the applicable jurisdiction rule will vary depending on the characteristics of each transaction.

V. Final Words

As mentioned above, distribution, franchise and agency agreements do not have any special treatment under Peruvian legislation and law.

Therefore, it is highly recommended to establish provisions on term, termination without cause, applicable law and jurisdiction in written agreements to avoid unnecessary delays or conflicts of interpretation.

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Investment Barriers in Peru: Guiding a U.S. Investor Through the Shoals

By Carlo Mario Viacava

I. Introduction

This presentation addresses the legal formalities which need to be fulfilled by a foreign investor when investing in Peru.

For the purpose of this presentation, we will define an administrative barrier as the actions performed by an administrative entity (ministry, regional government, or municipality, among others) which obstruct, limit and many times forbid the procedures designed to establish a formal business or a new investment.

A. Types of Foreign Investments

In order to determine the different barriers which a foreign investor may face, it is important first to enumerate the types of foreign investment which can be made in Peru:

- Contributions made by foreign individuals or entities to the capital of a new or already existing company, in freely convertible currency or in physical or tangible goods.
- Investments in national currency that have the right of being repatriated.
- Conversion of private foreign debt into equity.
- Reinvestment of profits made in accordance with current laws.
- Acquisition of assets located in Peru.
- Intangible technological contributions such as trademarks, industrial models, technical assistance and technical know-how (whether patented or not), which may be classified as physical goods, technical documents and instructions.
- Investments in securities, negotiable instruments or bank certificates in foreign or domestic currency.
- Resources for joint-venture agreements or similar contracts that grant the foreign investor participation in the productive capacity of a company without the foreign investor being involved.
- Any other types of foreign investment that contribute to the country's development.

B. Restrictions of Foreign Investment

Along with what we have defined as administrative barriers, there are specific restrictions on the participation of foreign investment in some activities. Thus, Article 71 of our Constitution states that foreign investors cannot acquire or possess, by any means, mines, land, water, forests, fuel or energy sources, directly or indirectly, within fifty kilometers of a national border. In addition, pursuant to merchant marine legislation, no foreigner may hold fifty percent or more of the shares of a Peruvian entity doing merchant marine transportation domestically. As for the capital restriction to foreigners on domestic commercial aviation entities, the government has recently lifted the existing investment restriction by establishing that no foreigner may hold fifty percent or more of the shares of these companies, during the first six months after the issuance of the operating permit, but after such period of time the foreigner may hold seventy percent of the shares of the Peruvian commercial aviation company.

Subject to the exceptions mentioned in the previous paragraph, all economic activities are open to foreign investment, with no restriction on the participation of foreign investors. Consequently, foreign investors (i) have the same rights as national investors; (ii) may acquire shares, equity interests or property rights from national investors; (iii) effect remittances in foreign currency of the entire amount of their profits after deducting the corresponding taxes (dividends received by foreign investors are subject to a 4.1% withholding tax); (iv) remit the entire capital in foreign currency; and (v) have access to short, medium and long term internal credit without limits. No governmental authorization is required for transfer of monies in the cases outlined in (i) through (iv) above but the remittances of foreign currency should be through the Peruvian banking system.

II. Investing Through the Incorporation of a New Legal Entity

We have enumerated the different alternatives which foreign investors have to channel their investments into Peru. One of the most common ways is the incorporation of a new legal entity.

In general terms, the administrative procedures needed to incorporate a subsidiary and a branch of a foreign company in Peru would be the following:

- Draft and sign the articles of incorporation (charter) and bylaws of the firm to be incorporated.
- Reserve the name of the firm to be incorporated with the local Public Registry (optional, but recommended).
- Open a bank account in Peru in order to make the initial capital contribution to the company to be incorporated.
- Formalize the charter and bylaws of the entity to be incorporated through a public deed effected by

a local notary public and then filed with the local Public Registry for its mandatory record.

Incorporation of a firm usually is completed in approximately fifteen business days after its filing with the Public Registry. If one or more stockholders, or any of the persons signing the charter and bylaws, is a foreign individual, it will be necessary to obtain a special permit from the Peruvian Immigration Agency to enable them to sign those documents in Peru.

It will also be necessary to appoint an attorney-in-fact in Peru if one or more foreign stockholders are not coming to Peru to sign the charter and bylaws. This appointment is given through a formal power of attorney that must be authenticated/legalized (i) by the appropriate authorities in the jurisdiction where it is granted, (ii) by the Peruvian Consul of such jurisdiction, and (iii) finally by the Peruvian Ministry of Foreign Affairs. This power of attorney must also be recorded in the local Public Registry. Likewise, if the power of attorney is executed in English, then it must be officially translated prior to being recorded. The same occurs if any of the seals or any part or document included in the power of attorney is not in Spanish language.

Moreover, if the stockholder granting the power of attorney is not a foreign individual, but a foreign entity, in addition to the power of attorney mentioned above it will also be necessary to obtain a certificate of good standing and an incumbency certificate evidencing (i) that the individual signing the power of attorney on behalf of the company has the authority to execute such a document and (ii) that the company exists and is in good standing.

A branch of a corporation incorporated and domiciled abroad can be established in Peru by a public deed registered at the Commercial Registry. The public deed must contain at least the following: (i) a document certifying that the main office in its country of origin is currently in existence and neither the bylaws nor the articles of incorporation contain any restriction against establishing a foreign branch; (ii) a copy of the bylaws and articles of incorporation; (iii) the agreement by the competent corporate body in the corporation to establish a foreign branch and to designate of at least one permanent legal representative in Peru; (iv) a proxy conferred to him or her to act on behalf of the corporation in Peru; and (v) the agreement of the corporation to submit to Peruvian law.

Furthermore, all newly created entities must comply with additional formal obligations, such as obtaining a Tax Payers Card with the local Tax Agency; complying with all tax, labor and legal obligations; opening and maintaining appropriate accounting, corporate and labor books; obtaining the municipal license to operate its businesses in offices in the relevant municipalities; etc.

Results from several studies by think tanks such as *Ciudadanos al Dia* and *Instituto Libertad y Democracia*, as well as a recently published report by National Institute for the Defense of the Competition and Protection of Intellectual Property Rights (INDECOPI), have shown that the most burdensome administrative procedure which a foreign or local investor seeking the incorporation of a new entity has to go through is to obtain the business license and other permits issued by the local municipality and other governmental organizations. In this connection, see the chart in Appendix A, developed by the *Instituto Libertad y Democracia.*

Every investor wishing to start a business in Peru must fulfill the following four requirements in order to obtain a business license, whether it is permission to open a store, factory, and some other enterprise.

- First, execute an affidavit which confirms that the person requesting the license is responsible for the establishment of the business and is going to use the business for legal purposes.
- Second, apply for the zone certificate or compatibility certificate, which certifies that the business can operate in the chosen location in accordance with planning and zoning regulations or ordinances of the relevant municipality.
- Third, obtain a certificate from the Civilian Institute, which certifies that the business complies with every safety requirement, including emergency exits, earthquake safe areas, and the like.
- Fourth, obtain a Tax Payer's Registry Number, for tax matters.

These procedures could be simplified by unifying the process, since it makes no sense that the cost and number of procedures required to obtain a license varies among the municipalities. A step forward in the effort to reduce the time this process normally takes has been the enactment of a new law establishing the so-called "Positive Administrative Silence": according to this legislation, if a municipality takes more time for issuing a resolution than the time established by law, the municipality will be deemed to have acted in favor of the user of the service.

III. Mergers

A. Antitrust Administrative Regulations

In contrast to other countries, with the exception of transactions in the electricity sector, Peruvian antitrust law has not established control laws for the pre-acquisition approval on antitrust grounds of mergers and acquisitions or any other form of corporate grouping. By Law No. 26876, published on 19 November 1997, INDECOPI must give prior approval for cases of mergers and acquisitions between companies rendering electricity services within the same interconnected system.

B. Notification of a Merger

There is no general need to notify any authority about a merger, unless a company participating in the merger is listed on the Lima Stock Exchange or is otherwise

obliged by a specific law to do so, as described below. Nevertheless, all companies must notify the Peruvian Tax Authority (SUNAT) about any merger, but only for tax purposes and not to obtain authorization.

Examples of sectors or entities that require prior authorization or notification from or to the relevant regulatory authority are the following:

- Publicly traded companies (listed on Lima's Stock Exchange) must inform the National Securities Commission (CONASEV) of any merger resolution adopted by its correspondent corporate body.
- Mutual funds must obtain prior authorization from CONASEV in order to execute a merger.
- Risk qualification entities (legal entities with the sole purpose of rating securities) must obtain pre-authorization from CONASEV to execute any amendment of their bylaws and/or any changes in their shareholders. It should be noted that all mergers will usually involve an amendment to the bylaws and/or changes in the shareholders' structure.
- Securities brokers (*agentes de intermediación*) must obtain prior authorization from CONASEV to amend their bylaws in the case of a merger.
- Investment funds must inform CONASEV of any merger agreement or changes in their shareholders' structure.
- Clearance and Settlement of Securities Institutions (ICLV) must obtain prior authorization from CONASEV to amend their bylaws and must also inform CONASEV of any merger agreement.
- Stock exchanges must inform CONASEV of any changes in the information provided at the time when CONASEV's authorization of organization was granted.
- Securitization companies must inform CONASEV of any amendments to their bylaws.
- Banking and insurance companies must obtain prior authorization from the Banking and Insurance Authority (SBS) in order to execute a merger.
- Pension Funds (AFP) must also obtain prior authorization from the SBS in order to execute a merger.

The above are merely a few examples of sectors or entities which require prior authorization or notification from or to the relevant regulatory authority and do not constitute a full list. The need for prior authorization or notification is determined on a case-by-case basis.

In the case of SUNAT, notification must take place within ten working days, counting from (i) the date on which the merger agreement is to be executed or (ii) the date of the public deed of merger, whichever occurs first. The failure to notify SUNAT of the merger within the period established by law is punishable by a fine of approximately US $856, which will be reduced if the notification occurs before SUNAT has acknowledged the non-compliance.

The General Companies Law requires the publication of the merger resolutions of the relevant corporate bodies of the merging companies. The filing of the merger in the Public Registry is also required by law.

C. Disclosure of Interests

1. Listed Shares

CONASEV has established rules for the disclosure of important facts relating to issuers of primary and secondary public offers of securities. Important facts include, for this purpose, mergers and spin-offs of the issuer as well as the issuance of shares, debentures or other debt securities to be placed in Peru and/or abroad by private or public offer.

In the case of a merger, the issuer is obliged to file the following information with CONASEV and the Lima Stock Exchange:

- Copy of the approved merger agreement project.
- Date from which the merger agreement project will be in force.
- The financial statements and any other economic and financial information which formed the basis for the adoption of the merger agreement of the companies involved.
- General and particular criteria, duly supported, to be used in the valuation of assets, the liabilities of each of the companies involved in the merger, and the method of application.
- The relation between the paid-up capital and "investment shares" before the merger. (Investment shares are a hybrid instrument created by a military coup in the 1970s, granting fixed income rights to employees of a company, but not however ownership rights.)
- If applicable, the benefits agreed to be distributed to the holders of capital stock or "investment shares," as well as any other particular privileges.
- The basis of the share exchange ratio, including the charts with the respective support and calculation method.
- Notice of the issuer's intention to maintain the registration of the shares in the stock market or of its intention to retire them from the market, if applicable.

Within two working days after registration of the merger in the Public Registry, the issuer or, if applicable, the absorbing or incorporated company, must deliver the final balance sheet and the public deed of merger to CONASEV.

Additionally, an important fact that must be disclosed to CONASEV and the Lima Stock Exchange is the transfer of shares representing ten percent or more of the subscribed and paid-up capital, as soon as the transfer has been informed to the issuer. Specifically, by way of confidential information, the issuer must communicate to CONASEV the start of any negotiations intended to result in the potential acquisition of a quantity of equity securities which would trigger the obligation to launch a public tender offer.

2. Unlisted Shares

According to the General Companies' Law, there is no obligation to disclose share interests in unlisted companies.

D. Labor Aspects

There is no specific labor regulation related to corporate acquisitions and mergers. However, one of the important Peruvian labor principles is the Continuity Principle.

Under this Principle, employees are transferred with the same benefits they had in the former company before the corporate acquisition or merger was agreed, such as vacations, bonuses and severance payments. For such a transfer to occur, an agreement is required involving the participation of the merging company, the merged company and the employee. This agreement should be filed with the Peruvian Labor Authority and should include a list of all the labor benefits the employee already has in order to avoid any future labor dispute. If the employee refuses to be transferred to the new company, the merging company has the option to dismiss him or her.

An alternative possibility could be that the merging company hires the employee under a new labor agreement. In this sense, the merging company and the employee must agree on the terms of the new labor agreement. This alternative has as a first step that the employee must finish his or her labor agreement with the merged company, which must pay the employee all his or her labor benefits.

According to Peruvian law, if the employer dismisses an employee without any legal reason, the employer has to pay the employee 1.5 times his or her salary per year worked up to a maximum of twelve months payment. If the employee resigns from the existing position, he or she will lose seniority. The merging company will assume the continuity of service of the employee in the case of an unjustified dismissal. Sometimes, if the employee refuses to resign, the merging company could dismiss the employee in which case it has to pay him or her an indemnity. In any case, the merging company will not be obliged to hire the dismissed employee.

IV. Currency Investments

Investments in foreign currency do not require any previous official authorization. There is complete freedom to hold and dispose of foreign currency in Peru and its value is set by market supply and demand.

V. Remittance of Capital, Dividends and Royalties

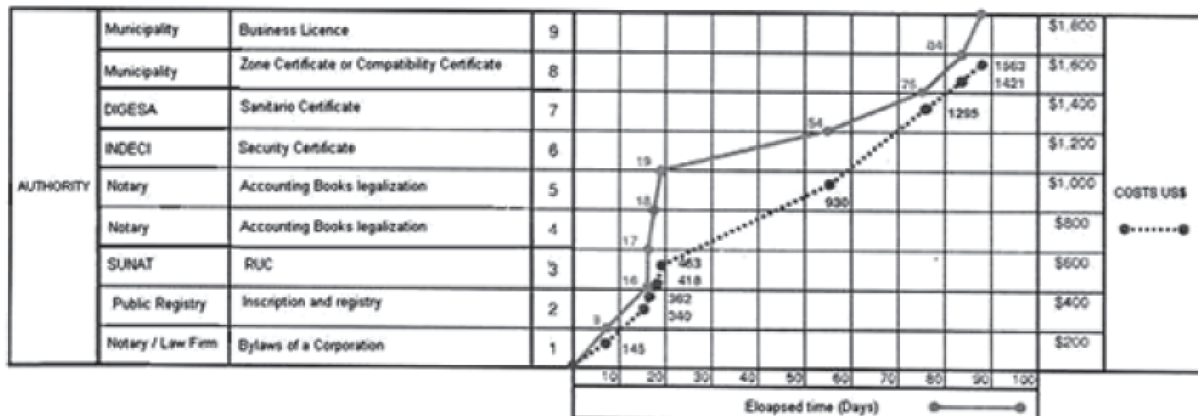
Foreign investors do not need any type of authorization to transfer abroad funds from capital, profits, dividends and royalties. These funds can be transferred in freely convertible currency after taxes are paid. Dividends and any other form of allocation of profits are levied with taxes. A rate of 4.1% will be applied, except for domiciled entities. On the other hand, royalties are subject to a withholding tax rate of thirty percent.

VI. Conclusion

Notwithstanding that Peruvian legislation is very friendly to foreign investments, there are several administrative barriers, such as permits, regulations and reports, which generate additional costs and which reduce the competitiveness of our country as a site for international business activity. We should work on reducing these barriers for the sake of the prosperity of Peru.

Mr. Carlo Mario Viacava is a member of the Lima law firm of Estudio Olaechea.

APPENDIX A



Immigration Guidelines for Foreigners Desiring to Work in Peru

By Alberto Varillas

I. Introduction

Foreign citizens who enter Peru seeking employment are subject to the provisions of Decree Law Nº703, Foreignness Law (*Ley de Extranjería*), and to Legislative Decree N°689, Foreigner Employees Employment Law (*Ley de Contratación de Extranjeros*) among other laws and regulations. Tourists are not allowed to work in Peru or even to enter into an employment contract (unless they obtain a special permit only for purposes of executing the contract); therefore having the proper visa when entering Peru is of the utmost importance in order to meet the legal requirements for a foreign citizen interested in working in Peru. This article covers, in a broad way, those legal requirements and contains some additional information regarding the employment contract a foreign citizen will need to enter into with a local employer, as well as a description of some of the main benefits the foreign citizen will be entitled to according to Peruvian laws.

II. Immigration Law Procedures and Requirements

A. General Framework

To better understand Peruvian immigration law, there are several basic principles with which one must be conversant. These include the following:

(1) All visas are for a specific purpose and a specific time. All foreign nationals seeking entry to Peru should hold the correct immigration permission for their intended activities and length of stay.

(2) All visitors must demonstrate their intent to leave the country. Anyone seeking to visit Peru must be able to demonstrate that they intend to enter for a limited purpose and that they will depart when that purpose is accomplished.

(3) Failure by a foreign national to maintain lawful status may subject both the individual and the sponsor to significant penalties. The employer is the sponsor of its employees in Peru. The failure of its employees to act in accordance with the terms and conditions of their immigration permission (including engaging in activities outside the scope of their status) can result in fines and penalties for the individual and for the employer.

(4) Foreign nationals are not permitted on a Peruvian employer payroll or entitled to begin a Peruvian work assignment with an employer without valid work authorization. No employee may enter Peru in advance of the required work authorization to start working. Preliminary meetings or visits are allowed.

(5) Violations of Peruvian immigration laws can have significant adverse effects on the individual and the sponsor. A person who enters Peru is granted entry for a specific purpose. Undertaking activities that do not correspond to that purpose can have serious adverse consequences for both the individual and the sponsor. Noncompliance can have a profound effect on the employer's future sponsorship of other foreign nationals or its activities. Failure to act in accordance with Peruvian laws and policies can result in criminal and civil penalties.

B. Migratory Status

Foreign nationals can be admitted to Peru with the following migratory statuses:

(1) *Diplomatic, Consular or Official*: This status is granted according to special dispositions issued by the Ministry of Foreign Affairs.

(2) *Political Asylum and Refugee*: This status is applicable subject to special regulations issued by the Ministry of Foreign Affairs.

(3) *Tourist*: That status is for foreign nationals who enter to Peru without seeking residence.

(4) *Transit*: This status is for foreign nationals that enter Peru in transit with another country as their final destination.

(5) *Business*: This status is available for foreign citizens not seeking residence but with the purpose of executing contracts and performing transactions. It does not allow the foreign citizen to receive income from a local source.

(6) *Artist*: This migratory status refers to those foreign nationals coming to develop remunerative artist activities. It is a requirement to have a contract duly approved by the appropriate authority in order to apply for the visa.

(7) *Crew Member*: This status applies to persons employed in working on or servicing foreign ships, vehicles and airplanes who are not seeking residence. They are not allowed to receive revenue from Peruvian sources.

(8) *Religious*: This status is a special one for members of religious organizations recognized by the Peruvian state. This migratory statute refers to those foreign nationals coming to Peru to perform activities related to the religion they profess.

(9) *Student*: This status is for foreign nationals entering Peru to study at schools or institutes recognized by the Peruvian government.

(10) *Work*: This status is for foreign nationals entering Peru to engage in labor activities under an employment contract with a company operating in Peru or for those national workers from foreign companies who travel to Peru to provide services.

(11) *Independent*: This status applies to foreign nationals entering Peru to make investments, enjoy *usufruct* from their rent, or practice their profession in an independent way.

(12) *Immigrant*: This status applies to foreign nationals that come to Peru to develop their activities in a permanent way.

These migratory statuses are classified into two groups: (i) temporary visas, i.e., tourist, business, artist, crew member and transit migratory statuses; and (ii) resident visas, which encompass all the others.

C. Migratory Status of Employee's Family

Once the foreign national has obtained the migratory status, such status may be applicable to his or her relatives (parents, spouse and minor children), through a *"Llamado de Familia"* (or "family call") request. Certificates of marriage and/or birth as issued by the competent authorities, duly legalized and notarized by the proper Peruvian Consulate, are required to apply for a "family call" visa.

D. Visas

Many foreign nationals are allowed to come to Peru under a tourist visa without any prior requirement. However, this must be confirmed on a case-by-case scenario based on the foreigner's nationality. Entry clearance (i.e., a visa) is normally issued for a specific purpose and is inserted in the passport at a Peruvian diplomatic post outside Peru.

Regardless of the foregoing, holding a Peruvian visa does not guarantee entry to Peru. An Immigration Officer may refuse entry to any person holding a visa in a number of circumstances, such as the following:

- The person has been deported from Peru or another country;
- The person has a criminal record;
- The Peruvian Health Authority considers entry a serious danger to the Peruvian population;
- The person has not given all the information relevant to his or her visit to Peru upon making the application;
- The person has, with or without knowledge, given false information to support the application; and
- There has been a change of the circumstances or reasons for going to Peru since the visa was issued.

Entry clearance is normally issued for a specific purpose. If the reason for going to Peru changes, the holder may need to obtain a new visa.

The temporary visa may be used by its holder within a period of six months after its date of issuance and allows a single entry and stay in the country during the entire effective period. If a temporary visa bearing the "multiple" seal is granted, it will allow the holder to receive income for a source different from the initial one while the visa is in effect. A temporary visa authorizes the admission and permanence of foreign nationals in Peru for up to ninety days, which may be extended in some cases.

The holder of a resident visa may use it during a six-month period after its issue date. It authorizes the admission and residence of a foreign national for up to one year, which may be renewed as long as the foreign citizen fulfills the residence conditions. Resident status allows a foreign national to depart and re-enter the country during the entire effective period.

E. Enforcement of Peruvian Immigration Law

Peruvian immigration law is complicated. Various agencies enforce the laws, regulations and policies applicable to all foreign nationals entering Peru. The relevant agencies are as follows:

- The Immigration Authority (or *Dirección General de Migraciones y Naturalización—DIGEMIN*), whose responsibilities include general immigration matters and issuance of visas and foreign identification cards. The Immigration Police are part of this agency;
- The Ministry of Labor and Employment, which is in charge of the approval of employment contracts with foreign citizens; and
- The Ministry of Foreign Affairs, whose responsibilities include the issuance of visas outside Peru.

II. Coming to Work to Peru

A. Obtaining a Visa

In general, foreign visitors to Peru are admitted under a tourist visa without any prior requirement. Nevertheless, before making travel plans all

foreign nationals must determine their entry clearance requirements.

B. Business Visa

Foreign nationals require a business visa to visit Peru on business. Business trip visas are issued for specific short-term assignments on behalf of a foreign company. The holder of a business-trip visa is not allowed to receive any remuneration for his or her services from Peruvian sources but is allowed to sign documents in his or her name or on behalf of a company. The holder of this visa is not allowed to work in Peru for the benefit of a Peruvian company, even if no remuneration is paid in Peru. Thus, a business-trip visitor may come to Peru to transact business, such as attending meetings and conferences, fact-finding missions, or to negotiate and sign contracts.

These visas are valid for ninety days and may be extended for a further thirty days. A business-trip visa usually allows single entry but may allow multiple entries.

Business-trip visas must be obtained by the individual at the Peruvian diplomatic post with jurisdiction over his place of residence. For such purpose, the following documents are usually required:

- application form;
- the individual's original passport;
- photographs of the individual;
- indicating the purpose of the individual's business trip to Peru and the places that will be visited, and containing a guarantee that it will bear the person's expenses during the trip; and
- the appropriate fee.

Processing time varies between diplomatic posts; however, the visa is usually issued in one or two days.

C. Work Visas

This Part addresses the most common work visas obtained by foreign citizens coming to work to Peru.

1. Residence Visa Based on Employment Contract (Residence Work Visa)

The residence work visa is based on an employment contract, subject to a minimum term of one year, previously approved by the Labor Administrative Authority and applies to foreign citizens who are employed directly by a Peruvian company. This visa will authorize residence in Peru for one year, and it may be extended by one-year terms as many times as required and as long as it is supported by an employment contract.

An application for a residence visa based on an employment contract must be submitted in Peru to *DIGEMIN* by a Peruvian company or by the employee while in Peru. In the first case, the visa application will be submitted in Peru, and, once the application has been approved, the employee must attend the Peruvian diplomatic post previously elected for the visa to be endorsed in the employee passport. If the residence visa is to be applied by the employee while in Peru, the employee should enter Peru with a business visa issued by the Peruvian diplomatic post and apply in Peru for a change of visa. As part of the procedure, an INTERPOL certificate will be needed. This is a document that has to be requested in Peru, and the procedure can be initiated the first time the employee arrives in Peru under a residence visa or business visa.

A residence visa is usually issued within forty-five to ninety days after application. The following documents are usually required:

- an application form;
- *Tarjeta de Embarque* (Immigration Form);
- a certified copy of the applicant's passport;
- an employment contract previously approved by the Labor Administrative Authority;
- the appropriate fee.

The process is complete when the foreign citizen is granted a foreigner's ID (*carné de extranjería*), which will be his or her official identification document for all purposes while working in Peru. An individual's entry into Peru will be regarded as illegal, and employee may be subject to expulsion, if he or she is found working in Peru without this visa.

2. Residence Visa Based on a Technical Services Agreement

Another type of residence visa is a visa for foreign citizens who are employed by a foreign company that has entered into a technical services agreement with a Peruvian company for a minimum of a one-year term. Holders of this visa may not be considered an employee of the Peruvian company, nor may they receive remuneration in Peru other than housing allowances and travelling expenses (if any).

An application for a residence visa based on a technical services agreement must be submitted in Peru to *DIGEMIN* by a Peruvian company or by the foreign national while in Peru. In the first case, the visa application will be submitted in Lima, Peru, and once the application has been approved, the individual must visit the Peruvian diplomatic post previously selected to have the visa endorsed in his passport. As part of the procedure, an INTERPOL certificate will also be needed and is to be requested locally. These visas are usually issued within forty-five to sixty days after application. The following documents are usually required:

- an application form;
- a certified copy of the applicant's passport;
- *Tarjeta de Embarque* (Immigration Form);
- a services contract executed between the foreign company and the legal entity to which the service is provided in Peru, legalized by the Peruvian diplomatic post;
- a document issued by the foreign company appointing the worker to perform the service in Peru, duly legalized by the Peruvian diplomatic post;
- the appropriate fee.

This process is also complete when the foreign citizen is granted a foreigner's ID (*carné de extranjería*).

3. Extension of a Residence Work Visa

A residence visa based on an employment contract or on a services contract authorizes residence in Peru for one year, which may be extended for another year as many times as required. The extension application should be submitted prior to expiration. If the visa expires prior to the filing of the extension request, the individual will be subject to a fine of US $50 for each three months of delay.

4. Temporary Work Visas

If the foreign citizen's assignment in Peru is for a short term one (i.e., no longer than a year), a temporary work visa, based on the contracts mentioned above in Part II.C.1 and 2, is also available through a simpler process. In these cases, for instance, no *carné de extranjería* will be issued.

III. End of Employment and Its Impact on Immigration Status

Regardless of whether a foreign national employee resigns, is terminated or is transferred outside Peru, cessation of employment in Peru triggers certain obligations and affects the individual's Peruvian immigration status. In such case, the foreign citizen must return his *carné de extranjería* and leave the country unless he enters into another employment contract.

IV. Approval of an Employment Contract with Foreign Citizens

A. Overview

As in most countries, the labor laws in Peru give preference to the hiring of Peruvian nationals over that of foreigners. Nevertheless, hiring foreign employees is permitted under certain formal conditions as explained in this Part.

B. Limitations and Exceptions to Hiring Foreign Employees

The law allows no more than twenty percent of an employer's personnel to be foreign; moreover, there is a payroll cap of thirty percent, that is, up to a maximum of thirty percent of an employer's payroll may cover foreign employees' salaries. In addition to certain other exceptions, these limitations do not apply if the foreign employee is any of the following:

(1) married to, or a son, father or brother of a Peruvian citizen;

(2) a citizen from a country with which Peru has a double citizenship agreement (e.g., Spain);

(3) an immigrant with such a visa in effect.

In addition, an employer may ask for a limitation exception if the employee is any of the following:

(a) a specialized or qualified employee in technical matters;

(b) part of the management staff of a new activity; or

(c) a teacher or scholar.

The contract cannot be executed for longer than a three-year term at a time. However, the term may be extended for no more three year terms as long as necessary.

C. Contract Requirements

Labor contracts with foreign employees must be executed in writing and approved by the Labor Ministry. To be approved, contracts must be submitted along with diplomas or study certificates and labor experience certificates of the employee. A "Technical Trainee Certificate" or similar document and a "Labor Experience Certificate" will meet the requirement when a professional degree is not available. All documents issued outside Peru must be legalized by a Peruvian consulate.

The employment contract must include a commitment from the foreign employee to train Peruvian employees for the tasks the foreign employee will be performing and a commitment from the employer to repatriate the foreign employee upon termination of the contract.

The approval process at the Labor Ministry should take between five to ten business days. As mentioned above, only after the employment contract is approved, the proper work visa is granted and the *carné de extranjería* is issued may the foreign employee start performing his or her duties and enjoying a salary.

V. Labor Benefits Applicable to Foreign Employees

A. Overview

In general, foreign employees are subject to the same rights and benefits that a Peruvian employee enjoys. However, since foreign employees are usually appointed to management positions, they will not be subject to the maximum daily work schedule and the overtime payment rules.

B. Summary of Benefits

The following is just a list of the main benefits applicable to a foreign employee.

(1) *Vacation*: The employee is entitled to thirty-calendar days' vacation for each complete year of services rendered to the same employer after fulfilling record-keeping requirements established by law, with payment of his full monthly salary.

(2) *Ordinary Gratuities*: Each 15 July and 15 December, employees are entitled to a gratuity of one month's salary for Independence Day and Christmas, respectively.

(3) *Severance Payment* (*Compensación por Tiempo de Servicios—CTS*): The employee is entitled to semi-annual deposits into the employee's special bank account in amounts equal to approximately half of his or her salary for each six months of employment; deposits can be withdrawn upon employee's retirement with certain exceptions.

(4) *Life Insurance*: Life insurance coverage is mandatory after four years of employment with the same employer. The insurance covers natural and accidental death and absolute permanent disability, with a payment equal to sixteen to thirty-two months' salary.

(5) *Profit-sharing:* Employees working for a company with more than twenty employees have the right to receive a share in profits, before taxes, which is payable fifty percent pro rata based upon days effectively worked by each employee and fifty percent in proportion to employees' salaries, according to the following scale:

Activity	Sharing %
Mining	8%
Fishing	10%
Manufacturing Industries	10%
Communications	10%
Restaurants, Wholesale and Retail	8%
Other	5%

(6) *Job Security*: If terminated without a just cause provided by law before the termination of the contract term, the employee is entitled to an indemnity of 1.5 month's salary for each month remaining until the end of the agreed contract term. The indemnity is capped at twelve months' salary.

C. Annual Salaries

It is customary to agree to the payment of annual salaries for foreign employees. In such cases, the agreement may include in such annual salaries, the benefits mentioned in Part V.B.2 and 3 above, together with some other benefits such as overtime or a family bonus (if applicable). For this agreement to be valid, the monthly salary must be not lower than two tax units (i.e., approximately US $2,000).

D. Some Tax Implications

It is worth mentioning that a foreign employee will be considered as a non-domiciled taxpayer during the first fiscal year working in Peru and, therefore, subject to an income tax rate of thirty percent on his or her gross income. Subject to certain conditions, the foreign employee will have the right to be subject to domiciled taxpayers' rates of fifteen percent, twenty-one percent and thirty percent beginning with the second fiscal year of employment. It is critical for the parties to consider this issue when agreeing on a net salary for the employee.

VI. Additional Information:

Some useful information may be found on the following Web sites:

- Dirección General de Migraciones y Naturalización—DIGEMIN

  www.digemin.gob.pe, which contains general information regarding visas (Spanish language only)

- Ministry of Foreign Affairs

  www.rree.gob.pe, which contains general information of Peruvian consular bodies

- Ministry of Labor and Employment

  www.mintra.gob.pe, which contains general information of the Ministry of Labor and Employment (Spanish language only)

- Estudio Aurelio García Sayán-Abogados

  www.garciasayan.com.pe

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Environmental Legislation in Argentina

By Guillermo Malm Green

I. Introduction

Argentina is a country where environmental protection and sustainable development are relatively new concepts.

Under the Argentine Constitution prior to 1994, the power to protect the environment basically fell within the overall concept of the police powers of prevention and control and, in principle, such powers were vested in the provinces, and devolved only by delegation to the central government. As a result, laws regulating sanitary working conditions, health, and industrial permits incidentally contained some provisions related to the protection of the environment.

This was not a deterrent, however, to the enactment of federal laws which created safeguards to protect the environment and established a federal enforcement authority. In turn, the provinces were empowered to issue and enforce additional regulations.

For a good number of years, this widely dispersed legislation and its lack of enforcement led many industries to eliminate their waste by dumping it in rivers, incinerating it, or delivering it to third parties and shrugging off any responsibility as to its final disposal.

Environmental protection started developing as a modern concept in 1993 with the enactment of the Hazardous Waste Law, which established a cradle-to-grave waste-tracking system, whereby the generator of the waste is considered liable for all damages it causes and is not released from liability even upon delivery of such waste to third parties.

II. Legislation

Argentina has enacted several laws at the federal and provincial levels basically establishing an "aggravated" strict liability system, but its consequences are not clear-cut. There are still gaps in the current legislation and relatively few case law precedents to give businesspeople and attorneys clear guidelines to follow when addressing the concept of environmental liability and its consequences applied to day-to-day situations.

A. Argentine Constitution; Federal Legislation

Section 41 of the Argentine Constitution recognizes the right to a healthy and balanced environment, the purpose of sustainable development, the "polluter pays" principle, whereby environmental damage generates the obligation to "restore" (subject to law), the right to information, and a ban on the entry of hazardous waste.

Pursuant to an amendment of the Constitution in 1994 the power to legislate on environmental matters is vested in the provinces. Nevertheless, the federal government has the power to legislate minimum standards to be met throughout the country. The following laws setting such minimum standards have been enacted by the National Congress since July 2002.

- Law No. 25,612,[1] regulating "minimum environmental protection standards for the overall management of industrial waste and waste originated in activities involved in rendering services."
- Law No. 25,670,[2] regulating "minimum environmental protection standards to manage polychlorinated biphenyls."
- Law No. 25,675,[3] regulating "minimum standards for the adequate and sustainable management of the environment, the preservation and protection of biological diversity and the implementation of sustainable development" (known as the "Framework Environmental Law.")
- Law No. 25,688[4] regulating "minimum environmental requirements for the preservation, development and rational use of water."
- Law No. 25,831,[5] regulating "the minimum environmental protection standards for the purpose of guaranteeing the free and public right of access to environmental information."
- Law No. 25,916,[6] regulating "the minimum environmental protection standards for the overall management of household waste of urban, commercial, medical care, health, industrial or institutional origin."

Although the enactment of these laws certainly implies some progress in the environmental legal framework in Argentina, the fact is that such laws have not been the supplemented by regulation and their scope has not been defined. This results in a high degree of uncertainty regarding the extent to which these laws will be enforced.

B. Civil Code in General; Fault-Based and Strict Liability

One of the main principles of Argentine Law is that damages must be repaired, and each person is liable for the damages he or she has caused or for damages caused by the things made by or dependent upon that person or the employees employed by or dependent upon that person. This fundamental legal principle establishes that there is no liability without fault.

Thus, Section 1109 of the Argentine Civil Code states the following: "Any person who, by acting *negligently* causes another to sustain damages, is bound to repair such damages. This obligation is governed by the same provisions to which torts are subject."[7]

The second part of the second paragraph of Section 1113 of the Civil Code establishes that, when damages are caused by the danger or flaws inherent in a thing, liability is only released, in full or in part, upon evidence that damages were caused due to a fault attributable to the victim or to a third party for whom the owner or custodian of the thing is not responsible. In this case, the liability of the owner or custodian ceases if the thing has been used against his or her express or implied consent.

This Section introduces the concept of "strict liability" to our positive law. The introduction of this cause-effect presumption sets aside the general principle of fault-based liability mentioned above.

Since damages caused by "dangerous" things entail strict liability, the damaged person only needs to provide evidence of the following:

- that there has been damage;
- that the thing is dangerous;
- that the thing caused the damage.

Section 1113 of the Civil Code establishes that the owner or custodian of the dangerous or flawed thing that has caused the damage may be fully or partially released from liability only by showing the negligence of the victim or a third party for whom the owner or custodian is not responsible. Third parties are all those people who are not, whether in an active or passive capacity, responsible for compensation purposes. However, not all acts by a third party are per se sufficient to release the owner or custodian from his presumption of liability. The following circumstances must also be present:

(1) A third party's negligent behavior;

(2) A third party for whom owner or custodian is not responsible; and

(3) A sufficient cause-and-effect relationship between the third party's act and the damage.

C. Waste-Tracking System; Aggravated Strict Liability

1. Waste-Tracking System

Federal Law No. 24,051[8] (HWL) (together with its Regulatory Decree 891/93)[9] governs the generation, handling, transportation and treatment of hazardous waste and establishes a cradle-to-grave waste tracking system, whereby the generator of hazardous waste is liable for all damages it causes and is considered liable even upon its delivery to third parties.

Basically, the HWL is applicable to the generation, handling, transportation, treatment and final disposal of hazardous waste that is generated or located (i) in places subject to national jurisdiction or (ii) in a province, but only if the waste is intended to be relocated outside that province. However, its general provisions regarding liability apply throughout the country.

The HWL defines "hazardous waste" as "all waste matter causing damage, whether directly or indirectly, to living things, or polluting the soil, the water, the atmosphere or the environment in general." In particular, the hazardous waste described in the annexes to the HWL is considered especially dangerous.

2. Regulation of Industrial Waste

Law No. 25,612 (the "Industrial Waste Law" or "IWL") passed in July 2002, regulates all kinds of industrial waste, and, pursuant to Section 41 of the Argentine Constitution, sets the minimum standards to be met throughout the country. This rule applies to *all* industrial waste, whether hazardous or not.

3. Hazardous and Industrial Waste "Dangerous" Under Section 1113

Both the HWL and the IWL establish a system of responsibility for damages caused by hazardous and industrial waste, which modifies the general liability system established by the Civil Code.

In fact, they set forth a *iuris tantum* presumption (i.e., a presumption allowing a party to prove the contrary) that all hazardous and industrial waste matter is considered "dangerous" under the terms of Section 1113 of the Civil Code.

In addition, these laws stipulate that the generator is responsible for damages caused by the waste matter it produces in its capacity as owner thereof. This liability continues even after delivery of the waste to the transporter or to the treatment or waste disposal plant. Accordingly, the HWL and IWL establish that the fact that ownership of hazardous and industrial waste has been transferred to third parties or voluntarily relinquished, cannot be invoked to excuse liability.

These laws further establish that the owner or custodian will not be released from liability, not even upon evidencing the negligence of a third party for whom the owner or custodian is not responsible *if* the damage could have been prevented by exercising the due care required in view of the circumstances.

4. "Aggravated" or "Enhanced" Strict Liability

As a result of these provisions Argentine environmental law has gone beyond the concept of mere strict liability for environmental damages, creating a more rigorous system, (what might be called "aggravated" or "enhanced" strict liability) since there are certain qualifications for the third-party defense to apply.

In sum:

- Hazardous, as well as industrial, waste is considered dangerous.
- The owner (i.e., generator) and custodian are deemed responsible for damages caused by hazardous and industrial waste.
- A defense alleging a third party's negligence can only be invoked if the damage could not have been prevented by "exercising due care in view of the circumstances."

It should be pointed out that, as an exception, the IWL provides that the generator will not be held liable for damages caused by waste matter if such waste is used as input of another productive process. This provision is not mirrored in the HWL in relation to hazardous waste.

5. Case Law Requiring Remedial Action

In spite of the fact that the rules mentioned above allow a person or entity to be discharged from liability if the person or entity can prove that the damages were caused by a third party and that the act could not have been prevented by exercising due care in view of the circumstances, recent case law rulings have required a generator of hazardous waste to take remedial action, prioritizing its liability as generator and custodian, regardless of the fact that the damage was caused by a third party.

In the case of *Municipality of Magdalena v. Shell Capsa,*[10] a collision of two vessels in the *Río de la Plata* caused the spill of fifty-three hundred cubic meters of oil. The oil reached the coastal area of the municipality of Magdalena. The municipality claimed that Shell should be obligated to dispose of the hazardous waste and restore the damaged environment. Although Shell argued that such obligations should be imposed on the party responsible for the collision and not on Shell since the spill was the consequence of the actions of a third party for which it was not liable, Shell was ordered to dispose of the hazardous waste and take remedial actions in its capacity as owner and guardian of the hazardous waste, regardless of its right to claim compensation from the other party.

It is worth mentioning that there are no rules stating the scope of the obligation to "restore" or how remedial actions are to be implemented; there are no guidelines or parameters to be followed in that respect.

D. Environmental Damage with a Collective Impact; Joint and Several Liability

Law No. 25,675 (the "Framework Law") sets forth what it calls the "minimum standards for the adequate and sustainable management of the environment, the preservation and protection of biological diversity and the implementation of sustainable development."

The main aspects of the Framework Law are as follows:

- It establishes that any work or activity which, in the Argentine territory, is likely to significantly degrade the environment, any component thereof or affect the people's quality of life is subject to an environmental impact assessment (EIA) proceeding; prior to the performance thereof the law sets forth that public hearings must be scheduled in the approval process of the EIA.
- It provides that individuals and legal entities must furnish information related to environmental quality and to the activities being carried out.
- It states that any individual or legal entity performing activities that may be hazardous to the environment must obtain insurance guaranteeing that any possible damages caused to the environment will be cured; likewise, on a case-by-case basis and depending on the alternatives, an environmental restoration fund may be created to implement restoration actions.
- It defines collective environmental damage as "any significant alteration adversely affecting the environment, its resources, the balance of the ecosystems or collective goods or values" and provides that the person causing such damage shall face strict liability, making such person responsible for restoration of the damaged environment to its prior condition. Likewise, the rule establishes that, should such restoration be technically impossible, the payment of substitutive compensation would be appropriate.
- When it is not possible to determine who the author of the damage has been if two or more persons are involved in causing collective environmental damage or if the extent of the damage caused by each of such persons cannot be accurately established, all of them are jointly and severally liable, without detriment, if applicable, to the right of contribution among them for which purpose the acting judge may determine the degree of liability of each such person.
- It establishes that the injured person, the governmental ombudsman, nongovernmental environmental protection organizations and the national, provincial and municipal governments have authority to demand that the damaged environment be restored, and that any person may request, by means of an action seeking the protection of constitutional rights, that the activities causing any collective environmental damage be discontinued.
- It provides that, should the damage be caused by entities, the authorities and professionals associated

therewith will also incur liability to the extent of their respective involvement.

E. Parent Company Liability

Generally, pursuant to Argentinean law, the different companies forming a corporate group would not be liable for the obligations of each other. The fact that a company is controlled by another does not imply that the parent company will be liable for the acts of its affiliate. Section 33 of Argentine Company Law 19,550 ("ACL") defines "controlled companies" as those in which another company, either directly or through a third company controlled by it:

(1) holds a sufficient equity interest, irrespective of the nature thereof, to be able to cast the votes required to exercise the decision-making power at corporate meetings or ordinary shareholders' meetings; or

(2) exercises a dominant influence by reason of holding shares, quotas or ownership interests, or by virtue of the special relationship linking the companies."

The following theories might lead to finding the parent company liable for environmental damages caused by the subsidiary:

(a) *Piercing the corporate veil:* The ACL has accepted the Anglo-Saxon theory of "piercing the corporate veil" in the *"Inoponibilidad de la personalidad jurídica"* notion established in Section 54, the last paragraph of which provides as follows:

> Action taken by a company to conceal the pursuit of non-corporate purposes or action comprising a mere resort to break the law, violate public policy or good faith, or injure the rights of third parties shall be directly chargeable to the partners or controlling parties who made such action possible, who shall be jointly and severally liable without limit for the ensuing damages.

Under Section 54 of the ACL the effect of piercing the corporate veil is the joint and several liability of the partners or controlling parties that "made the acts possible." It is understood that (i) joint and several liability is limited to the specific case; (ii) the other intra- and extra-company relationships are not altered; (iii) the company maintains its separate existence and its standing to be sued; and (iv) the company is not released from its own liability.

Legal authors and precedents have established that the application of Section 54 is both strict and restrictive.

(b) *Negligence "in vigilando"*: In connection with the duty to supervise, Section 1074 of the Civil Code provides that "[a]ny person who, by reason of his failure to act, causes damage to another person, shall be held liable if there is a legal provision that imposes on him the obligation to perform the omitted action." Our legal system provides for specific cases of liability for another person's acts, such as vicarious liability, liability for the danger or flaws inherent in the thing, liability of guardians and curators for the acts of the individuals under their supervision, liability of school principals, liability of hotel owners, and liability of shipmasters and shipping agents.

(c) *Directors, Administrators, Managers, Etc.:* The HWL and IWL, respectively, state that, in case of violations of those laws by corporate persons, "persons responsible for the direction, administration or management thereof" and "authorities and professionals" shall be jointly and severally liable. A plaintiff may use this or any other argument related to the effective management of the local company in order to try to hold a parent corporation liable for its subsidiary's environmental damage, thus "importing" foreign case law whereby parent companies were held liable for the acts of the subsidiary under arguments of "control" (e.g., *Amoco Cadiz,*[11] *Beazer*[12] and *Bestfoods*[13] cases) or by stating that the real authority for direction, administration or management authority lies with the parent company.

III. Case Law

As previously noted, Argentine environmental legislation is relatively new; as a result, there are few precedents in which the legal principles contained in current legislation have been construed.

A. *Aspiroz Costa, Francisco v. PASA S.A*[14]

On 27 October 2005, Panel J of the National Civil Court of Appeals of the City of Buenos Aires, in *Aspiroz Costa, Francisco v. PASA S.A.,* ratified the lower court's decision related to noise and odor nuisances.

The plaintiffs had filed a legal action requesting that PASA S.A. and others be required to perform what was necessary to put an end to the noise, odors and disturbances that were disturbing their tranquility and interfering with their right to rest.

The substantive defense put forward by the defendant basically consisted of allegations that (a) the area in the Province of Buenos Aires where it performed its activities was categorized as industrial, and (b) the noise standards for such category established by Resolution 159/1996 of the Secretariat of Environmental Policy, which makes (IRAM) Rule 4062/1984 of the Argentine Institute for the Rationalization of Materials applicable to the Province of Buenos Aires, were observed.

The lower court sustained the complaint based on the provisions of Section 2618 of the Civil Code, which establishes that disturbances may not exceed "normal tolerance, taking into account the site conditions, even if

there exists an administrative authorization therefor." According to the appellate court, this rule prevails over any administrative resolutions or noise thresholds established by the enforcement authority, regardless of the industrial categorization of the area where the factory was settled.

In this sense, the appellate court held that indirect interferences,[15] when they exceed normal tolerance, are to be considered, in principle, abusive and remedied by the discontinuance of the activity (or its adjustment, if pertinent) and the redress of damages caused. The obligation to put an end to or minimize annoyances is independent of the defendant's fault.

The lower court's judgment was affirmed, and the defendant was ordered (i) to cease all noises exceeding the standards fixed by administrative rules for rural areas (IRAM 4062/1984),[16] and (ii) to place on the plaintiffs' property, as close as possible to and as far as possible from the defendant's property boundaries with the adjoining properties, meters to monitor on a daily basis gaseous emissions to prevent emergency situations that might jeopardize the health or lives of the people living there.

It appears from the lower court's ruling that the factor used to measure noise levels was not strictly objective (as it was merely complying with the standards established by administrative rules), but had a subjective nature or characteristic or, at least, embodied a combination of both. In other words, even if the regulatory standards (i.e., the objective aspect) are met, the neighbors' normal tolerance may be disturbed (i.e., the subjective aspect), in which case the company must answer for the damages caused.

The appellate court has also affirmed judgments rendered in other situations where damages were awarded independently of the existence of administrative acts that authorized the activity.

Even though the lower court's holding in this case had not clearly established whether the noise *actually* exceeded the standards established by the regulations in force, the appellate court embraced the principle whereby the existence of noise and odors exceeding normal tolerance and representing more than a mere disturbance or annoyance do encroach upon the right to live in a healthy and balanced environment, irrespective of the fact that the area is categorized as rural or industrial.

B. *Sagarduy v. Copetro S.A*

On 28 March 2006, a panel of the Court of Appeals hearing Civil and Commercial matters in the City of La Plata, rendered judgment in the case entitled *Sagarduy v. Copetro S.A*,[17] dealing with, from different viewpoints, the notion of environmental damage and the manner in which to settle it in the event of claims brought by citizens.

Copetro S.A. was a company that for more than twenty-three years had been processing coke coal. As a result of its operations, Copetro released coke coal particles into the atmosphere and the adjoining neighborhood. Forty-seven plaintiffs, neighbors of Copetro, filed a complaint against Copetro for damages arising from environmental pollution generated by the company. The items claimed included injury of *ius utendi* and *ius abutendi*,[18] physical harm and emotional distress. The award entered by the court of appeals against the defendant amounted to ARS $1,991,633.34 in the aggregate, plus interest and legal costs. The plaintiffs proved to have suffered bronchitis, colds, dyspnea, skin and eye irritation, conjunctivitis, breathing, dermatologic and ophthalmologic conditions. The court concluded that in many situations, environmental damage results in physical harm, and that the reduction in the victim's generic vital ability, whether *actual or potential*, should be considered. This type of environmental damage must be repaired even if the harm is caused to persons especially sensitized due to a previous disease condition.

The court awarded between approximately ARS $14,000 and ARS $21,000 per person. The court also found that Copetro was polluting the air with particulate matter as a result of the coke coal dust released into the atmosphere. This situation injured plaintiffs' rights of use, enjoyment and disposal of property. Therefore, the court held, as damages for the detriment caused to the right of use and enjoyment, plaintiffs should be awarded ARS $20,000 per property, to be divided among the plaintiffs inhabiting each property. On the other hand, the award for damages for the detriment to the right to dispose of property hovered around ARS $6,000 and ARS $20,000 per property, which was to be collected by the owner of the property or divided among plaintiffs in proportion to their percentage interests in the relevant property.

Finally, the court held that, in light of the degree and duration of the emotional distress (almost twenty-three years), damages in the amount of ARS $15,000 should be awarded to each plaintiff, and it further found that interest should accrue on items claimed from the date on which such injury was caused.

The court concluded that the statute of limitations for damages in connection with neighborhood matters[19] was ten years.[20]

IV. Environmental Insurance

A. Obtaining Insurance

On 13 March 2007, Resolution No. 177/07,[21] issued by the Secretariat of Environment and Sustainable Development of Argentina, was published in the Official Bulletin. This resolution sets forth the operating rules for procuring insurances provided for in Section 22 of Law No. 25,675,[22] which is the Framework Law discussed above in Part II.D.

In brief, anyone engaged in activities listed in Annex I to Resolution 177/07 must, if they also have an environmental complexity level classified as 2 (medium) or 3 (high), procure the aforementioned insurance.

The activities that are listed in Annex I (pursuant to Resolution No. 303/07) were identified in accordance with the Uniform International Industrial Code. In turn, the environmental complexity level is derived from application of the polynomial formula detailed in Annex II to Resolution 177/07, which takes into consideration the line of business, effluents and waste, risk involved, size and location.

Depending on the environmental complexity level, the area where the activity is conducted and the risk entailed in it, the Unit of Environmental Risk Assessment will determine the minimum insurable amount. This Unit of Environmental Risk Assessment is a work group created within the structure of the Secretariat of Environment and Sustainable Development of the Nation.

B. Environmental Restoration Fund as Alternative to Insurance

Section 22 of the Framework Law sets forth, as an alternative to the procurement of insurance, the creation of an environmental restoration fund, that is, the formation of a reserve fund or self-insurance to cover any possible environmental damage with a collective impact.

Resolution 177/07 clarifies the wording of the Framework Law and expressly provides for self-insurance as a valid and adequate option to the procurement of insurance to cover such kind of damages. Pursuant to Resolution 177/07, however, those carrying on activities that may endanger the environment who are under the duty to procure insurance to cover any environmental damage must be financially and economically sound, measured according to certain requirements that will be established by complementary resolutions.

C. Unit of Environmental Risk Assessment

Pursuant to Resolution 177/07, the Unit of Environmental Risk Assessment has the following functions, among others:

(1) Regularly review and update Annexes I and II to Resolution 177/07;

(2) Assess the classifications made on the basis of the environmental complexity of industrial and services activities, pursuant to Annex II to Resolution 177/07;

(3) Participate in the determination of the minimum insurable amounts of each activity;

(4) Establish the applicable mechanisms and procedures for determining the condition of the environment upon creation of the financial guarantee and to certify the extent of damage caused to the environment;

(5) Approve the proposed plans of environmental restoration, mitigation or compensation and verify compliance therewith;

(6) Establish and implement the environmental provisions to be included in the insurance policies procured for coverage of environmental damage; and

(7) Establish the environmental contents and requirements to be included in self-insurance instruments.

D. Questions Relating to Resolution 177/07

The content of Resolution 177/07 and the manner in which it was issued give rise to a series of preliminary questions.

(1) Resolution 177/07 does not fix the insurance amounts. The only parameters established in section 3 of the Resolution (environmental complexity, area and risk) are extremely broad and leave the determination thereof to the opinion of the Unit of Environmental Risk Assessment. We believe that this Unit will not be able to establish a parameter that takes into account each risk and each environment, and therefore, it is possible that the standards to be fixed will be general and inadequate.

(2) Section 4 of Resolution 177/07 sets forth that the Unit of Environmental Risk Assessment Unit is to establish acceptable mechanisms and the procedure: (a) to evidence the condition of the area when insurance is procured; (b) to certify the extent of damage caused to environment as a consequence of the loss; (c) to approve the proposed plan of environmental restoration, mitigation or compensation; and (d) to verify compliance with the plans mentioned in (c). In the author's opinion, the Unit of Environmental Risk Assessment (a national authority) is not authorized under the Constitution to participate in the activities described in clauses (b), (c) and (d) above, since such rights are reserved to the provinces.

(3) Once the minimum insurable sums mentioned in (1) above are fixed, even if as of that date there would be no insurance policy available on the market, the creation of such self-insurance could be considered mandatory. However, according to section 5 of Resolution 177/07, to become self-insured every obligor must evidence financial and economic soundness. What the applicable standards will be and the possibility of investing such funds remain unanswered questions.

(4) Section 6 of Resolution 177/07 provides that the Unit of Environmental Risk Assessment will, among other things: (i) evaluate the adequacy of the guarantees provided for in the FEL and (2) es-

tablish the applicable mechanisms and procedures to evidence the condition of the environment when the financial guarantee is created. However, the Framework Law does not mention these "guarantees." The author believes that Resolution 177/07 refers to "guarantees" in general terms to address insurance and self-insurance, but this needs to be clarified.

V. Cells and Batteries

On 2 January 2007, Law No. 26,184 regulating certain cells and batteries became effective (the "Battery Law"). The Battery Law defines as "primary cells and batteries" any portable source of electric energy obtained through the direct transformation of chemical energy, composed of one or several primary disposable elements. In short, the new system prohibits the import and commercialization of certain cells and batteries and regulates a certification procedure as a prior requirement to authorize the import or commercialization of such cells and batteries.

On 15 January 2007, Resolution No. 14/07 issued by the Secretariat of Environment and Sustainable Development (SESD) was published in the Argentine Official Bulletin. Resolution 14/07 regulates the certification procedure established by Section Six of the Battery Law.

The highlights of the new system are as follows:

(1) The Battery Law prohibits the manufacture, assembly and import of prism-shaped or cylindrical carbon-zinc and alkaline-manganese primary cells and batteries whose mercury, cadmium and lead contents exceed:

(i) 0.0005wt% of mercury;

(ii) 0.0150wt% of cadmium;

(iii) 0.2000wt% of lead.

Likewise, it prohibits the commercialization of cells and batteries having such features from 26 December 2009 onward.

The Battery Law names as enforcement authority the "highest authority having jurisdiction over environmental matters," empowering it to reduce the aforementioned mercury, cadmium and lead limits. Nowadays, such authority is the SESD.

(2) The Battery Law provides that cells and batteries must satisfy the following requirements:

(a) The expiration month and year must be printed on the body of each cell.

(b) Cells must be airtight.

(c) Cells must meet the useful life requirements set by the *Instituto Argentino de Normalización y Certificación* (Argentine Standardization and Certification Institute) (IRAM).[23]

(3) The manufacturer, assembler or importer of cells and batteries must certify before the authorized agencies that the cylindrical or prism-shape carbon-zinc and alkaline-manganese cells and batteries do not exceed the limits mentioned in paragraph (1) above and that they satisfy the requirements described in paragraph (2) above.

The only certifying agency directly authorized by the Battery Law is the *Instituto Nacional de Tecnología Industrial* (Argentine Institute of Industrial Technology) (INTI).[24] Certifications are effective for a two-year term.

It is important to note that those devices or items containing, whether inside or outside, cylindrical or prism-shape carbon-zinc and alkaline-manganese cells and batteries, even if they can be easily removed, also require such certification.

(4) According to Resolution 14/07, an interested party must file together with the application for certification and the cell and battery certification instructions issued by the INTI (i) 60 individual unit samples per mark, model and origin of the relevant cells and batteries shipment and (ii) a list of distributors and/or intermediaries and the sales area.

In connection with the samples, Resolution 14/07 provides that, in case of devices or items containing, whether inside or outside, cells and batteries, such as toys or training shoes, 60 units of such products (or the quantity the certifying agency establishes) must be submitted.

Resolution 14/07 provides that the certifying agency is to use the ISO 4 certification model (evaluation of a representative sample and two more evaluations during the follow-up period) and—exceptionally (as described in the following paragraph)—ISO 7 (certification by batch).

Following delivery of the samples, the certifying agency has fifteen business days to make the technical evaluation and grant or deny the certification. If the technical evaluation is adverse, the certifying agency must give notice of such circumstance to the SESD and Customs. The SESD may order that "with respect to the interested party or the goods, future technical evaluations be made following the ISO 7 model (certification by batch)."

VI. WEEE

There are no regulations in force in Argentina on waste electrical and electronic equipment (WEEE). However, a draft bill has been introduced in the Argentine Congress, based on Spanish Royal Decree 208/2005. It is Bill S-207/06 on the Disposal of Obsolete Electric and Electronic Equipment and Waste Management (*Proyecto de ley sobre la disposición de aparatos*

eléctricos y electrónicos en desuso y gestión de sus residuos) (the "WEEE Bill").

A. Parliamentary Status

The WEEE Bill was filed in 2006 by Mr. Ramón Eduardo Saadi (politically affiliated to the *Justicialista* Party) and has been under consideration by several committees (Environment and Sustainable Development, Industry and Commerce, Work and Social Security, General Legislation, and Administrative and Municipal Affairs).

B. Main Aspects of the WEEE Bill; Comparison with WEEE Directive

This Part VI.B. provides a comparison of the main aspects of the WEEE Bill with the provisions of the European Community's WEEE Directive 2002/96/EC (the "WEEE Directive").

1. Definition of "EEE"

The definition of electric and electronic equipment (EEE) in the WEEE Bill is consistent with the WEEE Directive. It incorporates Annexes IA and IB of the WEEE Directive. The EEE categories and examples provided are identical to those in the WEEE Directive (save for some slight changes in the exemptions).

2. Definition of "WEEE"

The definition of waste electrical and electronic equipment (WEEE) is generally consistent with the WEEE Directive, except that the WEEE Bill does not explicitly refer to the Directive 75/442/EEC on waste as the WEEE Directive does. The definition of private household WEEE in the WEEE Bill is generally consistent with that in the WEEE Directive.

3. Exemptions

The WEEE Bill excludes "equipment used exclusively for military purposes that are necessary for national security." The WEEE Bill contains no reference to any EEE that is part of equipment. It does include the "Large-Scale Stationary Industrial Tool" exemption (Annex IA, Category 6 of the WEEE Directive), although it does provide a slightly differently worded exception: "except for permanently fixed industrial tools of significant size and installed by experts." The "Implanted and Infected Medical Device" exemption is consistent with the one provided in Annex IA, Category 8 of the WEEE Directive. Regarding health and safety legislation, the WEEE Bill refers to the "Law on Labor Risk Prevention."[25]

4. Producer Definition

The WEEE Bill textually reproduces the definition included in the Spanish Royal Decree 208/2005 and, consequently, the definition of producer under the WEEE Bill differs slightly from that in the WEEE Directive. According to the WEEE Bill, the term "producer" includes any individual or legal person who, irrespective of the selling technique used, including distant or electronic sale, does any of the following:

- manufactures and sells electric or electronic equipment under its own brand;
- puts on the market under its own brand equipment manufactured by a third party; or
- imports or exports such equipment from or into a third country.

An individual or legal person who only finances operations putting such equipment on the market is not considered a producer unless that person acts as a producer according to any of the above-mentioned categories.

5. "Put on the Market" Not Defined

Even though the WEEE Bill uses the expression "put on the market," it does not provide a definition.

6. Marking Requirement

The WEEE Bill contains a requirement for marking to include the identification of the producer. This requirement applies to "equipment" (it does not specifically refer to EEE nor does it exclude components). The WEEE Bill includes the requirement for marking of EEE with the crossed-out dustbin symbol, but, differing from the WEEE Directive, it applies only to private household EEE.

7. Registration Requirements

The WEEE Bill provides that producers and importers must declare before local authorities (i.e., those at the municipal or county level) whether they have chosen to participate in a collective scheme or to implement a private management system. Both collective schemes and individual management systems need to be approved by the local authority. The WEEE Bill[26] includes the details of the information that must be provided in connection with the approval of an individual management system and of a collective scheme.

The WEEE Bill provides that local authorities must provide the Secretariat of Environment and Sustainable Development[27] (which is the national environmental authority) with an annual report indicating the weight of WEEE that has been recollected, together with reutilization, recycling and recovery percentages achieved in the local jurisdiction.

8. Financial Guarantee Requirements

The WEEE Bill provides that producers opting for an individual management system must provide financial guarantees in the form of either insurance or a blocked bank account.

Producers who join a collective scheme do not need to provide additional financial guarantees. However, when

corresponding administrative authorization is sought for a collective scheme, it must make reference to its financing mechanisms and guarantees.

9. Information Requirements

a. Information to Users

The WEEE Bill provides that producers must inform users about the following:

- the criteria for the proper environmental management of private household WEEE;
- the availability of free separate collection for private household WEEE;
- the meaning of the crossed-out dustbin symbol, which is to be provided in the user instructions or in the guarantee or other documents accompanying the EEE; and
- the potentially detrimental effects on the environment and human health as a result of the presence of hazardous substances in EEE.

b. Information for Treatment Facilities

Regarding the scope of the producer information that is required to be provided to treatment facilities, the WEEE Bill stipulates that, within one year after a new piece of EEE is put on the market, producers must give treatment centers, upon their request, relevant information regarding the following:

- the manner of disassembly to allow identification of the different components and materials capable of being reused or recycled;
- location of the dangerous substances; and
- the ways to achieve, with regard to each piece of equipment, the goals related to reuse, recycling and recovery.

10. Reporting Requirements

The WEEE Bill also provides for periodic reporting obligations. Producers or importers not involved in a collective management scheme must annually provide the municipality in the jurisdiction where their registered office is located, with certain information, certified by an external auditor, as follows:

- EEE, by type of equipment put on the market in the national jurisdiction in the preceding year;
- WEEE collected from distributors or local authorities;
- WEEE directly managed or delivered to authorized waste managers for treatment purposes; and
- Evidence of compliance with targets.

Collective management schemes, within the first three months of each year, must provide to the municipality that has issued the relevant authorization a report certified by an external auditor regarding their activities in the previous year, specifying the quantities of each type of EEE put on the market in the national jurisdiction and the final quantities of managed WEEE, by category of products and materials, in each municipality.

11. Financing Regime and Collection, Treatment, Recovery and Disposal Requirements for Private Household WEEE

The WEEE Bill provides that users may return private household WEEE free of charge. The WEEE Bill requires distributors or sellers[28] to take back private household WEEE when selling a new piece of equipment (of an equivalent type or with the same function).

The WEEE Bill provides that municipalities with more than five thousand inhabitants must assure the selective collection of private household WEEE. Producers must collect WEEE from the municipalities' facilities and those of distributors and transport it to authorized treatment facilities. They may do so individually or through a collective scheme and are responsible for the costs of such transportation. In municipalities with fewer than five thousand inhabitants, the WEEE Bill provides for collection to be undertaken according to the rules determined by the relevant authority.

12. Penalty System

The WEEE Bill does not provide for fines, penalties or other sanctions but stipulates that the penalty system will be laid down through regulations.

VII. Perspectives

What is expected in the future? Stricter enforcement, more regulations.

The pressure exerted by the community in general, the precaution principle, the new technological developments—all of these factors may soon force the authorities to regulate industrial practices in greater depth and compel companies to incorporate new changes into their ongoing production process.

It is expected that future regulations will be enacted regarding the following matters:

(1) soil quality standards;

(2) water quality standards;

(3) air quality standards;

(4) mandatory environmental impact studies;

(5) voluntary clean-up;

(6) stricter enforcement vis-à-vis the control of dangerous substances that have not yet become waste matter;

(7) electromagnetic fields;

(8) adoption of international standards and limits; and

(9) class action and litigation by NGOs.

Endnotes

1. B.O. 29 July 2002.
2. B.O. 19 Nov. 2002.
3. B.O. 28 Nov. 2002.
4. B.O. 3 Jan. 2003.
5. B.O. 7 Jan. 2004.
6. B.O. 7 Sept. 2004.
7. Emphasis added.
8. B.O. 17 Jan. 2002.
9. B.O. 3 May 1993.
10. SCJN 19 Nov. 2002; L.L. 2003-C.
11. Oil Spill by the *Amoco Cadiz* off the Coast of France on 16 March 1978, MDL Docket No. 376 ND Ill. (1984), American Maritime Cases, 2123-2199.
12. *Beazer East, Inc. v. Environmental Appeal Board*, [2000] B.C.S.C. No. 1698.
13. *United States v. Bestfoods*, 524 U.S. 51 (1998).
14. JA 2006-I-455.
15. Disturbances caused by smoke, heat, smells, lights, noises, vibrations or similar damages arising from activities performed on neighbors' properties.
16. Similarly to the lower court judgment, the Ruling implicitly considered as basis the standards for this category—rural area—and not those pertaining to the industrial area category.
17. JA 2007-I, Vol. 2-64.
18. *Ius utendi* is Latin for the right to use and enjoy a property, whereas *ius abutendi* is Latin for the right to dispose of the property.
19. Section 2618 of the Argentine Civil Code establishes that "[n]uisance caused by smoke, heat, odor, luminosity, noise, vibrations or similar damage by virtue of activities conducted in neighboring property ***shall not exceed the tolerance limits***, taking into account the conditions of the place and even though such activities may be authorized." (Emphasis added.)
20. According to Section 4023 of the Argentine Civil Code.
21. Resolution No. 177/07 was amended by Resolution No. 303/07 issued by the Secretariat of Environment and Sustainable Development, also published in the Official Bulletin on 13 March 2007.
22. Section 22 of Law No. 25,675 establishes that "[a]ny individual or artificial person, whether public or private, engaged in activities that may endanger the environment, the ecosystems and their elements shall procure insurance with adequate coverage to ensure the funding of restoration activities intended to repair any damages caused; in addition, depending on the case and opportunities available, it may contribute to an environmental restoration fund allowing the implementation of remedial actions."
23. In the absence of updated IRAM standards, the standards set by the International Electrotechnical Commission or by the American National Standards Institute are to apply.
24. The enforcement authority is empowered to authorize other agencies or institutions having the necessary technical and professional capacity to make such certification.
25. Section 15 of the WEEE Bill states the following: "As regards workers' health protection and safety, the provisions of the Law on Labor Risk Prevention shall be applicable, together with the development regulations thereof and, in particular, the rules governing workers' health and safety protection against risks related to chemical agents at work and protection to workers against exposure to carcinogenic agents."
26. *See* Annex VI and Article 8(3).
27. The WEEE Bill refers to the "*Secretariat of Environment,*" which is erroneous, since the correct name is "*Secretariat of Environment and Sustainable Development.*"
28. Defined jointly by the WEEE Bill as any person that supplies EEE to another person or entity as a final user, in commercial conditions.

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Commentary: Brazil and the Barriers to International Trade

By Antonio Garbelini Junior

I. Introduction

Brazil's participation in international commercial agreements dates back to the time when it was a Portuguese colony. In 1810, when the Portuguese royal court had already established itself in Rio de Janeiro, Dom João VI signed a Friendship, Commerce and Navigation Treaty with England. This treaty conferred extraterritorial rights on British subjects living in areas under Portuguese control, making them subject to only British law.

Thus, for many years a British judge was in place to judge British subjects in Brazil, and a Royal Navy ship was stationed in Rio de Janeiro's Guanabara Bay to demonstrate that the British judge's judgments could be enforced immediately.

Dom João VI further assured England of the right to offer its merchandise in Brazilian territory upon payment of a fifteen percent *ad valorem* import tax, while Portuguese products were subject to a sixteen percent tax and the products of other countries were subject to a twenty-four percent tax.

Following this treaty, Brazil went on to enter into many other international trade agreements with other countries, as well as to participate in the multilateral trade system, starting with the creation of the General Agreement on Tariffs and Trade, or GATT. The GATT was signed in 1947 by various nations, including Brazil, which entered into force in regard to Brazil as of January 1948, through a Protocol for Temporary Application (PAP) pursuant to Law 313 of 30 July 1948.

While the GATT existed, Brazil's participation in international trade reached two percent of total collective international trade—double its current participation. In those years, Brazilian exports were focused on commodities, especially coffee. The economy was very closed, with high import taxes and a goal of establishing national industries by import substitution. During the 1970s and 1980s, internal prices were controlled by the Federal Government, and the nation's domestic industries benefited from the established market protections, though they showed no concern for productivity or the well-being of the consumer.

Shortly before the beginning of the operation of the World Trade Organization (WTO), which began as of 1 January 1995, the profile of Brazil's economy began to change. In 1990, then President Collor abruptly ended price controls, seeking to open the internal markets to international competition.

This was a disorganized period, since Brazil still lacked a legal framework that would allow it to deal with competition and regulatory issues. But within a few years a legal framework was implemented, and the economy, which had stalled in the 1980s, began to grow with the encouragement of, among other things, currency stability and privatization.

On the international trade front, Brazil actively participated in the Uruguay Round, seeking advantages in access to agricultural markets and requesting a reduction in the subsidies granted by the so-called Quad countries—the United States, Japan, the European Union, and Canada. However, Brazil itself was very reluctant to reduce its high import rates on industrial goods, a position that it still maintains (although the applied duties are not as high).

Currently, Brazil is one of the larger players in the WTO, both in terms of its participation in commercial litigation and in the negotiations that are being conducted in the Doha Round.

II. Legal Measures Taken by Brazil Before the WTO

Despite its modest participation in international trade (around one percent), Brazil is currently one of the greatest users of the WTO's Dispute Settlement System, ranking fourth among the members most involved in litigation at the organization. And Brazil was a petitioner in the first panel organized by the WTO, together with Venezuela, in a matter involving non-tariff barriers: In the case DSB 02, the United States was required to change a discriminatory measure that prevented the entry of gasoline originating from Brazil and Venezuela.

Since then, Brazil has participated in various panels (and has won the majority in which it was involved), as demonstrated in Appendix A attached to this article.

III. Problems Implementing WTO Decisions

Even though Brazil has participated in many Panel proceedings, it is clear to Brazil that recourse to the WTO's Dispute Settlement Mechanism does not ensure that the respondent Member will comply with the recommendations or the decisions of the Dispute Settlement Body (DSB). In such situation, it is incumbent upon the damaged Member to request that the DSB suspend conces-

sions or other obligations that have been made to the respondent Member, a procedure better known as the imposition of retaliations—although this word does not appear in the WTO accords.

But often WTO members who were authorized by the DSB to retaliate end up not doing so, because, in practice, retaliation can bring greater losses to the complainant member. The reason for this is that retaliatory measures imply raised tariffs and increased prices on the imported products affected, which often are consumed by a large part of the population.

Thus many decisions of the DSB have not yet been implemented, and others were only implemented long after a reasonable time for their implementation had passed. For example, in the cases of Brazil—Export Financing Programme for Aircraft and Canada—Export Credits and Loan Guarantees for Regional Aircraft, which dealt with the concession of subsidies for the manufacturing of aircraft, each of the countries was authorized to adopt retaliatory measures against the other. But, as of yet, neither has done so.

It is not only that there are problems in implementing the decisions of the DSB, but that the commercial damage suffered by the complainant member cannot be repaired throughout the dispute settlement procedure. This is so because the retaliation can only be imposed for noncompliance with a decision of the DSB, which does not include the period before the decision. What is more, often retaliation for raised import tax quotas on a certain product not only fails to repair the damage suffered, but can even harm the consumers in the sectors of the economy that depend on the imports affected by such measure. Thus, often this option is the equivalent of "shooting oneself in the foot."

In other situations, the costs involved in a dispute settlement procedure and the problems associated with the application of retaliatory measures, especially for small economies in conflict with large ones, like the U.S. or E.U., mean that certain violations aren't even questioned before the WTO.

To analyze what this means in terms of time and value, Mexico presented a study at the WTO, in which it determined that an illegal measure could remain in force for roughly three years before the affected member could obtain some form of compensation or be able to suspend the concessions dealt with in the Understanding on Dispute Resolution. The Mexican study estimated that the average value of damage suffered by the petitioning member, from the beginning of a panel procedure until the time the requested member obtains authorization to suspend concessions, to be approximately US$ 370 million.

Thus, the Mexican study concluded that there was no incentive for compliance with WTO accords. This would only be reached through mechanisms that would permit the recoupment of losses from the point when a violation of such accord occurred, rather than from the time of the DSB decision.

However, since it has already become clear in the Doha Round that there will be no alterations in the system of suspension of rights and concessions currently in place, it would be necessary to implement alternative mechanisms that would permit the more rapid and effective resolution of commercial conflicts, especially those referring to the imposition of non-tariff barriers, such as the technical barriers and sanitary and phytosanitary barriers. Brazil has recently faced problems with the imposition of embargos on its beef exports for alleged sanitation problems. However, in the majority of cases, the barriers imposed have more of a discriminatory character, seeking to impede Brazilian products from competing with local products, rather than being concerned with human health.

The Brazilian government has tried to resolve these episodes with diplomacy, since, as seen above, litigation at the WTO would only be sensible when no other option for agreement is possible. However, this diplomatic mechanism is also slow and inefficient, since it is not subject to any type of rules.

Thus, an alternative for the resolution of conflicts generated by the imposition of non-tariff barriers would be the establishment of bilateral or multilateral agreements, of joint procedures to be developed by bodies or agencies in charge of sanitary inspection or of control of regulations or rules in countries involved in commercial litigation, as a way to reach a quick solution based on technical criteria that put an end to the conflict.

IV. The Use of Anti-Dumping Agreements as Barriers to Exports

Finally, it must be said that Brazilian exporters have noticed that there seems to be a tendency in some countries to encourage requests for anti-dumping investigations, perhaps as a way to inhibit imports, since the mere fact that such an investigation has been started results in the reduction of imports of the product involved to the importing country. Studies have indicated that a reduction in the imports of the investigated product arise from a simple request for an antidumping investigation because importers fear potential payments at the end of the investigation. Once an investigation is started, the tendency is that the importer will replace the exporter with another from a country not under investigation.

The Chamber of Foreign Trade (CAMEX) has found, for example, that, after opening an antidumping investigation of the export of Brazilian shrimp to the U.S. (which culminated in the application of antidumping duties against Brazilian companies), sales of this product in the

U.S. were reduced from $75 million to $35 million per year.

Within the WTO, a debate has started over this issue of the usage of mechanisms, outside the scope of GATT and of the antidumping agreement, that encourage the opening of an antidumping investigation. In 2003, the dispute settlement body of the WTO, in a proceeding requested by several countries, including Brazil, demanded that the United States alter a legislative measure known as the Byrd Amendment, because they found that it violated provisions of the antidumping agreement. In fact, the Byrd Amendment was effective until the end of September 2007. Since last year, the U.S. has been subject to the imposition of compensatory measures, i.e., retaliations, on the part of the plaintiff countries.

The Byrd Amendment authorized the dispersion of amounts paid as antidumping duties among the American companies that requested the investigation. This mechanism was clearly aimed at encouraging companies to open antidumping investigations, since such companies would benefit not only from the reduction of imports due to the opening of an investigation, but also from the resources extracted from its competitors, which could be applied freely to business promotion, marketing, or even discounts, further broadening their competitive advantage.

Thus it is reasonable to presume that some countries may be abusing the rights established in the WTO agreements against dumping practices harmful to their commercial interests. This could imply the gradual transformation of an instrument originally conceived to repress unfair commercial practices into an improper non-tariff barrier.

Therefore, what is left to learn is the position of the WTO in the event this tendency is confirmed or even broadened. Within some jurisdictions, such as Brazil, abuse of rights is known and repressed. However, at the WTO the issue is more delicate, since there is the assumption of good faith in the acts practiced by its members.

This appears to be more of a political issue than a legal one, waiting for the WTO members who do not improperly use the antidumping agreement as a non-tariff barrier to pressure those who do use it improperly to preserve the spirit in which the WTO was created: to spur trade free from barriers for the benefit of the world's well being.

Appendix A

I - AS COMPLAINANT—22 CASES:

1. **DISPUTE DS4** United States—Standards for Reformulated and Conventional Gasoline
2. **DISPUTE DS69** European Communities—Measures Affecting the Importation of Certain Poultry Products
3. **DISPUTE DS70** Canada—Measures Affecting the Export of Civilian Aircraft
4. **DISPUTE DS71** Canada—Measures Affecting the Export of Civilian Aircraft
5. **DISPUTE DS112** Peru—Countervailing Duty Investigation against Imports of Buses from Brazil
6. **DISPUTE DS154** European Communities—Measures Affecting Differential and Favorable Treatment of Coffee
7. **DISPUTE DS190** Argentina—Transitional Safeguard Measures on Certain Imports of Woven Fabric Products of Cotton and Cotton Mixtures Originating in Brazil
8. **DISPUTE DS208** Turkey—Anti-Dumping Duty on Steel and Iron Pipe Fittings
9. **DISPUTE DS209** European Communities—Measures Affecting Soluble Coffee
10. **DISPUTE DS216** Mexico—Provisional Anti-Dumping Measure on Electric Transformers
11. **DISPUTE DS217** United States—Continued Dumping and Subsidy Offset Act of 2000
12. **DISPUTE DS218** United States—Countervailing Duties on Certain Carbon Steel Products from Brazil
13. **DISPUTE DS219** European Communities—Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil
14. **DISPUTE DS222** Canada—Export Credits and Loan Guarantees for Regional Aircraft
15. **DISPUTE DS224** United States—U.S. Patents Code
16. **DISPUTE DS239** United States—Anti-Dumping Duties on Silicon Metal from Brazil
17. **DISPUTE DS241** Argentina—Definitive Anti-Dumping Duties on Poultry from Brazil
18. **DISPUTE DS250** United States—Equalizing Excise Tax Imposed by Florida on Processed Orange and Grapefruit Products
19. **DISPUTE DS259** United States—Definitive Safeguard Measures on Imports of Certain Steel Products
20. **DISPUTE DS266** European Communities—Export Subsidies on Sugar
21. **DISPUTE DS267** United States—Subsidies on Upland Cotton
22. **DISPUTE DS269** European Communities—Customs Classification of Frozen Boneless Chicken Cuts

II - AS RESPONDENT—14 CASES:

1. **DISPUTE DS22** Brazil—Measures Affecting Desiccated Coconut
2. **DISPUTE DS30** Brazil—Countervailing Duties on Imports of Desiccated Coconut and Coconut Milk Powder from Sri Lanka
3. **DISPUTE DS46** Brazil—Export Financing Programme for Aircraft
4. **DISPUTE DS51** Brazil—Certain Automotive Investment Measures
5. **DISPUTE DS52** Brazil—Certain Measures Affecting Trade and Investment in the Automotive Sector
6. **DISPUTE DS65** Brazil—Certain Measures Affecting Trade and Investment in the Automotive Sector
7. **DISPUTE DS81** Brazil—Measures Affecting Trade and Investment in the Automotive Sector
8. **DISPUTE DS116** Brazil—Measures Affecting Payment Terms for Imports

9. **DISPUTE DS183** Brazil—Measures on Import Licensing and Minimum Import Prices
10. **DISPUTE DS197** Brazil—Measures on Minimum Import Prices
11. **DISPUTE DS199** Brazil—Measures Affecting Patent Protection
12. **DISPUTE DS229** Brazil—Anti-Dumping Duties on Jute Bags from India
13. **DISPUTE DS332** Brazil—Measures Affecting Imports of Retreaded Tyres
14. **DISPUTE DS355** Brazil—Anti-dumping Measures on Imports of Certain Resins from Argentina

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Commentary: The Search for Legal Professionalism

By James P. Duffy, III

I. Introduction and Overview

The purpose of this article is to engage in a search for a definition of "legal professionalism." Thus, this will necessarily be a discussion of ethics, because a lawyer must be ethical. But it will also be a discussion of much more.

The author wishes to thank Professor Timothy P. Terrell of Emory University Law School for his considerable input into the materials used for this article. Professor Terrell has written extensively on topics relating to legal ethics and legal professionalism. Much of what he has written has been published, and some of that published material is referenced in this article. Much of his work is also private, and Professor Terrell has very generously made that material available for this article, and the author of this article appreciates having been able to draw liberally on it.

Professor Terrell, tracking conventional American legal thought, defines the principal ethical values of the legal profession as:

(a) Competence;

(b) Diligence;

(c) Information;

(d) Discretion (confidentiality);

(e) Loyalty (avoiding conflicts of interest);

(f) Independence of professional judgment; and

(g) Honesty or trustworthiness.

However, Professor Terrell goes on to postulate that these ethical values alone do not lead to legal professionalism because they simply define the minimum acceptable conduct for a lawyer. Thus, adherence, without more, to the ethical standards of the legal profession does not lead to legal professionalism. That being said, there cannot be legal professionalism without adherence to the ethical standards of the profession.

Professor Terrell identifies the qualities of legal professionalism[1] as follows:

(i) A commitment to "excellence";

(ii) A commitment to "integrity";

(iii) A respect for the system and rule of law;

(iv) A respect for other lawyers and their work;

(v) A commitment to accountability to clients and society more generally; and

(vi) A responsibility for adequate distribution of legal services.[2]

Professor Terrell considers these to be fundamental principles of legal professionalism. In other words, unlike ethical values, which tend to be more static, professionalism can be a more dynamic concept, because it is aspirational.

Notice that there is some overlap between the concept of legal ethics and legal professionalism. The ethic of excellence roughly corresponds to the ethical value of competence. The ethic of integrity roughly corresponds to the ethical value of honesty and trustworthiness. Depending on the point of view, there are no ethical values per se that correspond to the responsibility for the adequate distribution of legal services.

II. Distinguishing Legal Professionalism from Legal Ethics

An important distinction separates legal professionalism from the more familiar topic of legal "ethics." Over time, the latter has become synonymous with efforts in every jurisdiction to establish the minimum standards to which all members of a profession must adhere simply to maintain their licenses to practice. Professionalism, on the other hand, is *aspirational* in character. It is about lawyers at their best, rather than their acceptable least. This drive for superior quality is more, however, than simply a point of personal pride, for it is based in the profession's profound importance to our social heritage: the indispensable connection of the practice of law to the maintenance of civil community everywhere. Professionalism is therefore the set of qualities that those lawyers who consciously preserve and extend that legacy continually aspire to embody.

Because legal professionalism is a quality "above" the requirements of the rules of legal ethics, we assume as "givens" certain basic duties that are essential to law practice of any sort: for example, competence, diligence, loyalty to a client, honesty, independent judgment, and duties of confidentiality. Our task will be to identify the demands beyond these ordinary and necessary basics that legal professionalism imposes on those who aspire to provide superior legal services.

Like so many concepts of values, there are often conflicts among them. Thus, some of the fundamental

principles of lawyer professionalism will, if extended too far, conflict or interfere with ethical values or other values of lawyer professionalism. A simple and obvious example in another area would be the notion of freedom of speech. Although we all enjoy freedom of speech, none of us is free to commit perjury.

Professor Terrell postulates that these fundamental principles of legal professionalism have an area of intersection. He further postulates that, in the search for lawyer professionalism, one must focus on this area of intersection or overlap. This is the area in which, the Professor postulates, the professional lawyer resides in the combined effect of the fundamental values. Professor Terrell further postulates that, at this intersection, there is yet another set of values that derive from the first set of values, which the Professor calls fundamental virtues.

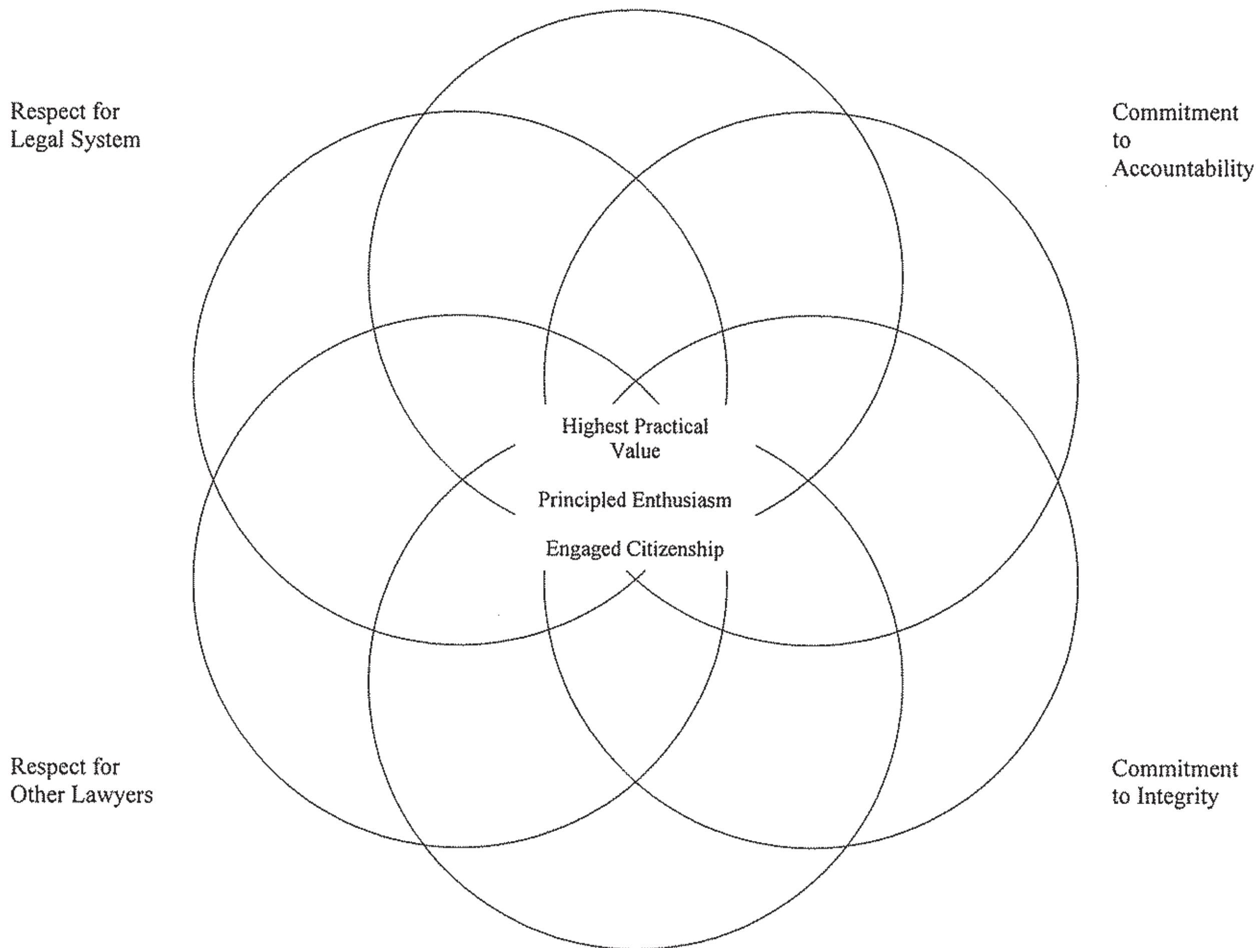
III. The Intersecting Elements of Legal Professionalism

Legal professionalism is a complex concept, just as the practice of law is a complex profession. It is best defined as an amalgam—a synthesis—of qualities having two layers or levels: First, legal professionalism is composed of six key, or fundamental, values, each separately important, but all jointly necessary to describe the approach to practice of the most respected lawyers. Second, these six separate fundamental values, when combined, form three fundamental virtues that capture the full professional maturity to which lawyers who practice at the highest level aspire.

The constituent elements of legal professionalism, each to be discussed in more detail below, are these:

The Fundamental Value	The Combined Virtues
• A commitment to excellence	• Delivering to a client the "highest practical benefit"
• A commitment to integrity: a duty to say no to a client	• Representing a client with "principled enthusiasm"
• A respect for the system and rule of law: a duty to explain why one has professional limits	• Practicing "engaged citizenship"
• A respect for other lawyers and their work	
• A commitment to accountability for one's work	
• A responsibility for the adequate distribution of legal services	

The interconnected relationship of all these values is much easier to diagram or display graphically than it is to describe. It can be depicted by the following Venn diagram of overlapping circles, with each separate circle representing a particular value, the overlap of the circles depicting the inevitable influence of each value on the others, and the central area of the diagram symbolizing the region of the "combined virtues" listed above.



In the following discussion, an attempt is made to develop each of these six fundamental values of legal professionalism. Then, the three combined fundamental virtues they create are examined.

IV. The Fundamental Values of Professionalism

A. A Commitment to Excellence

Within the practice of law generally, the quality of an individual's work is an obvious point of departure, for little else matters if the job performed by the lawyer is second-rate or the client's interests have not been thoroughly addressed. All clients certainly deserve the lawyer's appropriate attention and the full measure of his or her expertise. But as a matter of legal professionalism, excellence means more than just immediate "skill" of some sort. What is required is a "commitment" in the sense of an *attitude:* a deeper sense of direction concerning how to conduct oneself as a professional and what to expect from one's colleagues. Although excellence might be associated with particular results, a commitment to excellence is a long-term dedication to providing the best service possible to a client, overcoming whatever obstacles, in terms of knowledge or circumstances, that might compromise that responsibility.

This critical aspect of professional character is not limited, however, to the individual lawyer: it extends as well to groups of lawyers bound together professionally, whether in private firms, corporate legal departments, government agencies, or otherwise. Within these entities, the ethic of excellence creates a responsibility of that group to develop internally an "environment" of excellence: an expectation that the firm or office will generate within itself the appropriate support services, intellectual resources, and thoughtful supervision that will enable its lawyers to flourish professionally, and thus be the strongest assets for their clients that they can be. "Excellence" in this setting means pressing for the "highest common denominator."

B. A Commitment to Integrity: The Duty to Say No

Although the concept of "excellence" is relatively easy to grasp, even if it is difficult to measure, the value of "integrity" is more complicated than most realize. Particularly in the context of professionalism, it means much more than simply honesty. It is "a wholeness or unity of person, an inner consistency between deed and principle."[3] In the practice of law, it entails the lawyer's ability to remain steadfast and consistent when the stress

of delivering strong client service pushes against the lawyer's own personal and professional values.[4]

The value of integrity is therefore closely related to the idea of "professional independence"—the capability of a lawyer to exercise unclouded and uncompromised judgment on behalf of a client. In its starkest form, it is the question of the point at which the lawyer must reject a client's direction or request for service: when the answer must be no. Furthermore, to become a commitment to integrity, this resistance to inappropriate pressure must become "a habit of mind,"[5] a "virtue exercised over a lifetime."[6]

For lawyers, then, a commitment to integrity becomes synonymous with *trust*: Can a client, or a fellow lawyer with whom you are working, rely upon you to deliver advice that is unwelcome? As painful and economically dangerous as this may be in the short run, professionalism demands a recognition of the long-range benefit produced by forthright appreciation of the limits of the law.

This does not mean, however, that lawyers have a responsibility to, or that clients should expect that their lawyer will, sacrifice the client's interests to some "higher good," whether defined by the lawyer personally or by societal forces. Instead, integrity requires a lawyer to recognize a middle ground between, on the one hand, simply being a slave to a client, mindlessly doing whatever one is told, and, on the other, assessing each of the client's requests for its moral or political "worthiness." This principled position does not involve moral rationalizing, in which the lawyer engages in self-deception, imaging that the client's interests are indeed the lawyer's own. To the contrary, *professional* integrity simply demands that integrity be understood in a professional context: In private practice, the lawyer is being paid by a client, not by the public, which necessarily means that the client is entitled to have the lawyer act *as if* the client's interests were his or her own. Rather than abandoning one's personal values, legal professionalism requires a lawyer to engage in what could be termed a *principled substitution of principles*, in which the lawyer recognizes that one of his or her own principles is to vindicate the values of the client—up to the limits of the law.

This final restraint is an important one, of course, but it is much narrower than many in the public realize. An ethic of integrity means that a lawyer can be trusted to be consistently zealous in pursuing a client's interests up to the point that other values *within legal professionalism*—not values that the public may from time to time hold dear, and not even the general and vague idea of the "common good"—constrain the lawyer's actions. And the primary constraint of this kind will be the lawyer's respect for the rule of law.

C. Respect for the System and Rule of Law: The Duty to Say Why

If integrity is to have any practical meaning, rather than being some pious platitude, then legal professionalism requires that a lawyer be able to explain a refusal to act as a client directs or desires. This means that there must indeed be some "good," that is, some value that is "higher" than the client's immediate interests. But this should not be, as noted above, the amorphous concept of the "common good." This is not to say that social welfare is empty of meaning, and thus irrelevant to the practice of law. Instead, to be a legitimate part of *legal professionalism*, the "public interest" must be understood more narrowly and specifically.

The challenge presented to the practice of law by these claims of larger or deeper social concerns is the difficulty in defining satisfactorily and consistently the nature of the "good" that is alleged to be "common" or the "interest" that is supposed to be shared by some unidentified "public." Lawyers must constantly confront clashing and interweaving interests that must be resolved and untangled, and reasonable people can very much disagree concerning which path to doing so is truly appropriate. Yet there does exist one value upon which everyone in civil society *can* agree—one that is not only essential to the fabric of any community but is also a value at the heart of lawyering itself: the critical importance of the rule of law. Citizens connect with each other in significant part by the way they make claims against each other: When disputes arise, rather than resort to self-help, we invoke our system of law to vindicate our rights. The practice of law, then, is central to this fundamental aspect of modern culture.

Legal professionalism, in turn, requires lawyers to acknowledge their intimate connection to, and responsibility for, the rule of law. Part of that duty is to practice law in such a way that we do not compromise the legal system's ability to structure social relationships appropriately and efficiently, and to resolve disputes fairly and as harmoniously as circumstances will allow. Lawyers must recognize that the social usefulness of the legal system and, in turn, the esteem in which lawyers are held by the general public depend ultimately on the respect the law receives from non-lawyers. Others will understand the importance of the rule of law to their communities only if lawyers themselves take seriously their responsibility to hold the system and rule of law in respect. And only with that public understanding will society accept that, to preserve our communities, lawyers must be able to act with independent professional judgment, unimpeded by inappropriate pressure from either clients or government.

D. Respect for Other Lawyers and Their Work

A fourth value within legal professionalism follows directly from the former discussion: If we truly respect the

rule of law and appreciate its importance to our civic culture, then we must also respect those who labor within it. This, then, is the proper foundation for the requirement of "civility" among lawyers: not simply to enable people to interact without unnecessary social and personal pain, but to permit the legal system to function without unnecessary interference and cost. Although the limits lawyers impose on themselves in the name of civility will always be vague and somewhat controversial, this restraint will nevertheless always be connected with legal professionalism: Our respect for each other will inevitably continue to have an impact on the functioning of the legal system.

The respect required by legal professionalism extends beyond just contacts among lawyers, however. It includes as well a special responsibility involving a lawyer's conversations with his or her clients. When discussing other lawyers who are representing a client's opponents, or judges who may have ruled unfavorably in a matter, legal professionalism demands that these adversaries not be held in disrepute or denigrated behind their backs in a misguided effort by the lawyer to curry favor with the client, or to explain away an adverse result. The obvious exception to this restraint, however, is the circumstance in which the actions by the opposing lawyer were themselves contrary to legal professionalism. This more limited range to legitimate criticism of other practitioners recognizes that the public's respect for the rule of law will be closely related to the respect it gives to those who practice it.

E. A Commitment to Accountability

Accountability in the context of legal professionalism is a lawyer's recognition that clients—and, by extension, society as a whole—are entitled to understand the services that the lawyer renders and, in addition, to be convinced that the fees charged for those services are appropriate. The obvious point here is that lawyers must bear in mind that the practice of law is a *service* industry: Private practice involves being paid a fee by a willing client who is convinced that he or she is receiving something of value in the exchange. The days of the imperious lawyer who can command respect and payment simply from the status of being "the lawyer" are gone. They have been replaced with relationships that are closer to ordinary consumerism, where market forces (long disdained by many in the legal profession as beneath their dignity) now rule. Legal professionalism requires lawyers to recognize, accept, and indeed respect that situation. Those lawyers who reflect the profession's deepest values will readily be able to do so.

Accountability is therefore the cornerstone of the professional independence that lawyers enjoy, for the public generally accepts the proposition that lawyers need to be unfettered to be able to provide their full value to society. But people will continue to believe this only if lawyers respect their reciprocal duty to take seriously the need to make the value of their work clear, and their fees fair.

F. A Responsibility for Adequate Distribution of Legal Services

The final separate value constituting legal professionalism is the particular responsibility of lawyers to assist in the effort to make legal services as widely available in society as possible. This element, like all the others discussed here, has as its foundation the importance of the law to the civic community everywhere: Because law pervades all significant social arrangements and institutions, legal services must be widely available to members of society, and the legal system must function adequately on their behalf. Although governments obviously have a basic responsibility to create the structures and foundations of the legal system, legal professionalism requires lawyers in particular to go further.

"*Pro bono publico*" is the usual term for this duty, but it must be understood in proper context. Although "pro bono" work is well-known as work done by lawyers on behalf of clients who cannot otherwise afford to pay the lawyer's fees, this activity is not required as a matter of *legal professionalism* because some people have the misfortune to be indigent. Instead, the duty exists because of a lawyer's commitment to the law and the rule of law. *All* members of the public, rich and poor alike, should have the impression that the legal system is available to them for redress, vindication, and protection. For law to serve its vital function as an aspect of the social glue that holds society together, it cannot be a special province of a select and fortunate few. Lawyers, therefore, as members of the profession directly responsible for the health of the legal system, have a unique duty to involve themselves in activities that will make legal services pervasive.

This responsibility can be met in various ways. The most obvious, of course, is volunteering directly to work for organizations established for this purpose, such as legal aid offices. But within the context of the demands of professionalism more generally, the pressure to fulfill this responsibility must be tempered by the lawyer's responsibilities to clients who are otherwise paying for the lawyer's time and attention. The requirements of excellence and accountability dictate that pro-bono work cannot be allowed to compromise the efforts ordinarily associated with private practice.

This important sense of balance and perspective has important implications not only for individual lawyers who are trying to honor professionalism within the context of busy lives, but also the law firms where they work. On the one hand, it is not appropriate to impose on all lawyers an expectation that they will individually and personally engage in pro-bono work, for the demands of practice will cause either that work or the work on behalf of the firm's clients to be impacted inappropriately. But on

the other, it is appropriate to expect all law firms to make it at least reasonably possible for their lawyers to meet this professional duty. As an aspect of professionalism, then, law firms should recognize an "enabling" responsibility for pro-bono services: They should avoid, again at the very least, internal policies, practices, or incentives that discourage law firm members from becoming involved in such work, and instead to the extent possible, encourage and honor such work.

V. Professionalism's Combined Basic Virtues: The Hallmarks of the Best Lawyers and Firms

A. Introduction

A final, but crucial, step in the effort to define legal professionalism is to examine the *combination* of the separate values, that is, to determine the nature of law practice at the center of the earlier diagram of concentric circles. The blending that occurs there is itself important, for the interaction of the various values produces a distinctive set of three fundamental virtues, listed earlier, that uniquely define the practice of law at its very best.

B. Highest Practical Value

Professionalism's demand for "excellence" and "accountability" creates a sense that a client's interests should be vindicated in the most effective—and efficient—manner possible. This does not mean that the best lawyers always "win" from the client's perspective, whether in litigation or in the negotiation of a deal. Instead, these lawyers, and their firms, should be able to link their efforts to results they can fully justify as a professional matter. Excellent and accountable lawyering in this sense therefore means producing the highest "practical value" or benefit for the client in the circumstances. The client, in other words, should be in the best position that could reasonably have been achieved, and the lawyer should be able to demonstrate that positive result to the client.

This concept of "practical value" can be difficult to articulate, but the professional skills on which it is based can be identified. The following diagram summarizes the progression of professional maturity that characterizes the most respected lawyers:

Reason carefully	Master effectively	Act pragmatically
thorough	[perception ⟶] focused	efficient
logical	[command ⟶] coherent	useful
precise	[control ⟶] confident	professionally engaging

To the left in the diagram are the basic analytic skills—the rigorous thinking—that should be produced by a law school education. Any good lawyer should, early on, be able to understand the importance of investigating the facts and the law thoroughly on behalf of a client; be able to reason in a logical, syllogistic order through a series of analytic steps to an appropriate conclusion; and be precise and careful in his or her thinking, rather than loose and haphazard. But professionalism will push lawyers further: They will hone their reasoning, through experience and reflection, to truly master the area of law with which they deal. This lawyer will be able to perceive within the haze of facts and law the *correct* elements on which to focus to best serve the client's interests. In turn, this command of the material will enable the lawyer more readily to make his or her thinking evident and comprehensible to *others*, not just to himself or herself. With this strong grasp of the situation, the lawyer moves from mere facility with the material to a deeper confidence in the message he or she will deliver, giving the client an equal confidence in the value of the lawyer's advice.

For the best lawyers, professionalism produces additional steps. Adroit and resourceful lawyering also enables one to act pragmatically in the client's best interests. Concerning the lawyer's reasoning, this means that research and results must be achieved with minimum expenditure by the client, that is, professional products must be generated efficiently. From the client's perspective, those results must also be practical, reasonable, and realistic. And the best lawyers also understand that, because confidence can sometimes be perceived as arrogance, they must temper their approach to, and interaction with, clients and others with a professional character and attitude that is engaging rather than smug or haughty.

C. Principled Enthusiasm

The professional values of "integrity" and "respect for the rule of law and other lawyers" are sometimes understood to mean that a lawyer's efforts in advocating a client's interests must be measured, restrained, and aloof, in other words, that the relationship between lawyer and client must be distant. Although there is some truth to this perspective, it should not become exaggerated.

"Excellence" is still a foremost value of professionalism, and it demands that clients be given "zealous" representation. The proper balance between these considerations can be labeled "principled enthusiasm."

Clients pay their lawyers not just for results, but for *attitude* as well. Clients are therefore entitled to a special commitment from their lawyer, meaning that the best lawyers will manifest and cultivate traits that demonstrate their *lack* of neutrality concerning the client's interests: "bias, interest, partiality, [and] favoritism."[7] This commitment should be combined with a passion and energy that produces, consistent with the virtue discussed above, the highest practical benefit that a client can expect.

This enthusiastic representation must, however, be professionally tempered. Although a lawyer's advocacy cannot be unlimited or unrestrained, the source of constraint—as a matter of *professionalism*—must be understood as being rooted in considerations particularly relevant to the practice of law, rather than morality more generally. "Principled" enthusiasm must take into account the other critical professional values of "respect for the rule of law" and "respect for the work of other lawyers." Thus, professionalism demands that the pursuit of client service cannot go so far as to denigrate or bring into disrepute a community's body of law or its legal system: Advocacy should not cause the public to lose, or even doubt, its sense that society is governed by the fairness and justice inherent in the rule of law, as distinct from the whims of the few and the powerful. Zealous representation must therefore entail appropriately *legal* representation.

D. Engaged Citizenship

Professionalism's demand for "excellence," combined with a "respect for the rule of law" and a "commitment to wide distribution of legal services," means that the best lawyers are not passive and invisible purveyors of private business-related services. Instead, they are more publicly engaged and committed participants in the political and social processes on which the legal system depends. They are, in short, leaders in their communities.

This involvement, however, as a matter of professionalism, requires more than just being generally socially aware and active: it is more focused on the intersection of law and society. This might mean, for example, in particular circumstances, representing those least able to defend themselves or, more generally, participating in the political process to pursue legal reforms that will enhance civil and individual rights or economic development. One characteristic manifestation of this professional "zeal" is membership and participation in bar associations of various kinds, through which the practices of the best lawyers often have significant civic impact. All of this is "engaged" citizenship, which pushes the practice of law *beyond* client service.

VI. Conclusion

The practice of law has forever been, and will always be, subject to undeniable economic pressures and difficult moral choices, both of which can cause concern that professionalism is under constant threat. But the best lawyers understand that this tension is simply inherent in the effort to provide superior client service. Their willingness to meet these challenges while aspiring to the highest professional values is what earns for them the highest respect within their profession.

Endnotes

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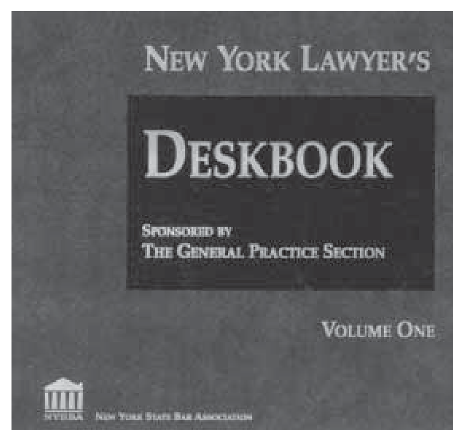

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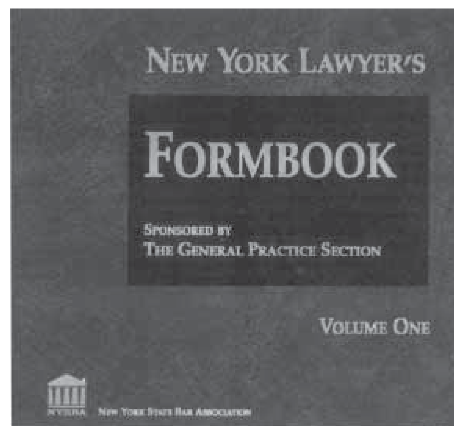

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