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INTERNATIONAL SECTION

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New York to Sydney: Navigating Currents in International Law

By Hon. Jonathan Lippman

Good morning. I'm sorry that I can't be there in person with you, but I am delighted that, through the wonders of technology, I can still be a cyber presence today as we have this dialogue on what I believe will be some very interesting issues and developments involving Sydney, Australia, and New York State.

I want to salute Chief Justice Spigelman, and the entire judiciary and bar of New South Wales and all of Australia. I have learned so much about your justice system, and I have been tremendously impressed by your dedication to improving the administration of justice, both domestically and around the globe.

I had the privilege of meeting Chief Justice Spigelman when he visited New York City this summer. We had a very interesting conversation based on our shared perspectives as the chief judges of states that are so influential within our respective countries, and we talked about the many problems and interests we have in common.

One of the topics we discussed was how the current financial crisis is affecting the court systems in New South Wales and in New York. Recognizing that the crisis is international in scope and that our global economy is intimately interconnected, we are seeing a marked increase in litigation involving foreign parties and cross-border legal issues. It is increasingly common these days for a court adjudicating a dispute in one country to have to determine and apply the substantive law of another country. It can be particularly difficult for the adjudicating court to ascertain and apply foreign law due to language barriers and/or the lack of available resources about the other country's laws and legal systems. Even where the other country is a prominent one whose laws are readily available, there may not be a controlling precedent on point and the adjudicating court is put in the uncomfortable position of having to decide what the other country's law is. At times, this is little more than judicial guesswork.

It was interesting to hear the Chief Justice explain how the process for the determination of foreign law questions by Australian courts has been somewhat unsatisfactory, particularly the prevailing approach of relying on the parties' expert witnesses to explain what the applicable foreign law is and how it should be applied. The Chief Justice noted that the experts' testimonies routinely conflict with each other, and there is a feeling among Australian judges that they are not receiving sufficient or definitive guidance about the correct application of foreign law to an actual dispute. In particular, they don't often feel that they are in the best position to interpret close or open questions of foreign law or to exercise discretion in any kind of nuanced way in individual cases. He also pointed out that the use of expert witnesses results in foreign law being treated as a question of fact in Australia, and not of law.

There really should be a better way—a mechanism whereby courts of different countries can communicate with each other so that the adjudicating court can receive reliable and neutral assistance in its efforts to correctly apply the law of the foreign nation.

What Chief Justice Spigelman proposed—and it immediately resonated with me—was that we work together to develop a protocol to facilitate mutual cooperation and assistance between our respective court systems. That made a lot of sense to me, given New York City's status as the world's commercial, financial and legal center. Many of the leading lawyers and law firms specializing in international law are located here, and many deals and contracts are negotiated and finalized here, with New York law often governing. Clearly, New York's courts and judges have a strong interest in making sure that foreign courts determine and apply our law correctly in their decisions. This is also in the best interests of our sophisticated legal community and our state economy. Indeed, with the accelerating pace of globalization, courts all over the world will increasingly be called upon to decide cases involving the laws of foreign nations. Shouldn't we as bar leaders and judges be more proactive in recognizing this trend and taking steps now to advance the administration of justice internationally?

On a more practical level, cases involving the application of foreign law can be among the most challenging and time-consuming for domestic judges, who are not trained in or familiar with foreign law systems and/or foreign languages.

The current systems for ascertaining foreign law in the United States are far from perfect. This was made only too clear by the United States Court of Appeals for the Seventh Circuit in the case of *Bodum USA, Inc. v La Cafetiere, Inc.*,[1] which involved a contract dispute between a French firm and a British firm. The contract was written in French and the dispute was clearly governed by French substantive law. Judge Easterbrook wrote the majority opinion for the three-judge panel, all well known and influential jurists in the United States. All three judges agreed on how to interpret the contract, but Judges Posner and Wood filed separate concurring opinions that focused specifically on the practice of using expert witnesses to establish foreign law.

Federal Rule of Civil Procedure 44.1 provides that courts may consider expert testimony when deciding questions of foreign law. However, in Judge Easterbrook's view:

> Trying to establish foreign law through experts' declarations not only is expensive (experts must be located and paid) but also adds an adversary's spin, which the court then must discount. Published sources such as treatises do not have the slant that characterizes the warring declarations presented in this case.[2]

Judge Posner in his concurrence not only agreed with that statement but went so far as to call the reliance on expert witnesses an "unsound judicial practice."[3] He wrote:

> Lawyers who testify to the meaning of foreign law, whether they are practitioners or professors, are paid for their testimony and selected on the basis of the convergence of their views with the litigating position of the client, or their willingness to fall in with the views urged upon them by the client.[4]

According to Judge Posner, judges should, whenever possible, search through published materials and treatises as the better means of providing "neutral illumination" on issues of foreign law. In his view, the use of experts is excusable only when the foreign law is that of a country with an obscure or poorly developed legal system and no secondary published materials are available.

Judge Wood filed a concurring opinion vigorously defending the use of experts:

> I am unpersuaded by my colleagues' assertion that expert testimony is categorically inferior to published English-language materials. Exercises in comparative law are notoriously difficult, because the U.S. reader is likely to miss nuances in the foreign law, to fail to appreciate the way in which one branch of the other country's law interacts with another, or to assume erroneously that the foreign law mirrors U.S. law when it does not.[5]

According to Judge Wood, the experts' views can be tested in court to guard against the possibility that they are acting as mere mouthpieces for the parties.

The *Bodum* case is quite relevant to the New York State courts. Proof of foreign law in New York is governed by CPLR 3016(e) and CPLR 4511(b), which require that foreign law be pleaded and that the parties furnish the court with sufficient information to enable it to comply with the request to take judicial notice of foreign law.

As a practical matter, New York judges are in the same position as their federal colleagues in terms of having to rely on the parties' expert witnesses, appoint a special master to report back, or perform independent research. What my federal colleagues on the Seventh Circuit don't say in their opinions, but which I know to be true at the state level—where our caseloads are just overwhelming, approaching nearly five million new filings annually—is that our state courts are simply too busy to make independent determinations of foreign law. As a practical matter, they are constrained to rely on the experts produced by the parties.

What is also interesting about *Bodum* is the absence of any discussion about alternative approaches to ascertaining foreign law, approaches that might be more effective than judges doing their own research or relying on the testimony of expert witnesses. Is there a better way that we just are not talking about?

One such alternative is a system that would allow certification of questions of law between the courts of foreign countries. The certified question of law has a long history in the English speaking world, going back to the British Law Ascertainment Act of 1859 and the Foreign Law Ascertainment Act of 1861. The first Act permitted a court in one part of the British Commonwealth to remit a case for an opinion on a question of law to a court in another part of the Commonwealth. The second Act allowed questions of law to be certified between British courts and courts of foreign countries, provided that each country was party to a convention governing such a procedure.

The United States has a shorter but extensive history with certification of questions of law, a history that arises from our separate state and federal judicial systems and that dates back to the U.S. Supreme Court's 1938 ruling, in *Erie Railroad v. Tompkins*, that there is no federal common law and that the law to be applied in any case is the law of the state, as declared by its legislature in a statute or by its highest court in a decision.[6]

Since that time, every state except North Carolina has adopted a system, either by constitution, statute or court rule, that allows for certified questions of law from the federal courts.[7] Typically, the federal courts and/or the high courts of sister states may send unsettled questions of state law to the state's highest court for authoritative resolution, thereby eliminating the need for federal or other state courts to engage in speculation about the law of a particular state.

I can speak from personal experience in saying that this system has worked very effectively for many years in New York. The New York Court of Appeals is authorized under the state constitution to answer certi-

fied questions of law from the U.S. Supreme Court, any U.S. Circuit Court of Appeals or the highest court of any state.[8] In a typical year, we receive anywhere from five to ten certified questions, predominantly from the Second Circuit Court of Appeals, but we have also answered questions from the Eleventh Circuit, the Third Circuit, and the Supreme Court of Delaware. All told, the Court of Appeals has answered almost one hundred certified questions over the years.

From my discussions with my federal colleagues, there is no question that certification has become an increasingly important tool for federal courts seeking to ascertain New York law, particularly where the Court of Appeals has not previously spoken on a particular issue.

All of which brings me back to my conversation with Chief Justice Spigelman. I think we both felt that some kind of procedure along the lines of the certification model would be very helpful, and we both felt that our respective judicial systems should exercise leadership roles in pursuing workable mechanisms for international judicial assistance that would contribute to the fair, objective and expert application and resolution of questions of New York and Australian law.

Certainly, Chief Justice Spigelman has already been pursuing that objective at the international level. The innovative Memorandum of Understanding executed in June 2010 between the supreme courts of Singapore and New South Wales provides that, if a contested legal issue in proceedings before one party is governed by the law of the other party, then each party can direct the litigants to take steps to have that legal issue determined by the courts of the party of the governing law.

While I was certainly interested in working with Chief Justice Spigelman to formalize cooperation between our respective judicial systems, having an Australian court refer certified questions of law directly to the New York Court of Appeals for authoritative resolution does not appear possible under existing law. The 1985 state constitutional amendment establishing New York's certified question procedure does not include the courts of foreign nations, and since the jurisdiction of the Court of Appeals is delineated very specifically under Article VI, § 3 of the state constitution, the Court of Appeals could not assert jurisdiction over certified questions from foreign courts without a further constitutional amendment.

While I intend to propose just such an amendment in the future, amending the constitution in New York is a difficult and uncertain multi-year process, requiring passage by two separately elected legislatures, followed by the approval of the State's voters at the ballot box. There were other concerns to grapple with in establishing a suitable protocol, including the restriction on courts issuing advisory opinions, the prohibition on judges accepting a public office or trust, and judicial ethics issues.[9]

What we came up with is a less formal arrangement than the Chief Justice initially contemplated, but I believe it will go a long way toward helping us achieve our mutual goal of facilitating cooperation between our respective court systems, while making sure that New York's courts and judges do not exceed their powers. What we have devised is modeled on the judicial referee system common to the New York and Australian legal traditions. A standing panel of five judges—one from the Court of Appeals and one justice each from our state's four Appellate Divisions—will be asked to participate in this initiative based on their outstanding reputations and demonstrated experience and competence in international and commercial law matters.

These volunteer judicial referees will be available, not in their official adjudicative capacities but in their unofficial capacities, to offer responses to questions of New York law referred to them by the Supreme Court of New South Wales. Such questions would be referred with the consent of the litigants involved.

Pursuant to our Memorandum of Understanding, the terms of each referral must identify the following: (1) the precise question of New York law to be answered; (2) the facts or assumptions upon which the answer to the question is to be determined; and (3) whether and, if so, in what respects the referees may depart from the facts or assumptions and/or vary the question to be answered. In addition, the MOU makes clear that the question presented must be a substantial question of law so that the referee panel is not asked to expend time and resources addressing issues that are not central to the resolution of the Australian proceeding.

Of course, the Supreme Court of New South Wales would be available to provide reciprocal assistance to our appellate courts with regard to questions concerning the articulation and application of Australian law—again with the litigants' consent. In New South Wales, Uniform Civil Procedure Law section 6.45 permits a party to a foreign proceeding to take out a summons for an answer to a question of Australian law. If such a summons is filed, a Justice of the New South Wales Supreme Court could issue a declaration of Australian law or the matter could be referred to a judge to act as a referee.

In New York, pursuant to an Administrative Order that I will issue shortly, the five judicial referees will be randomly assigned to work collegially in three-member panels. They will be expected to issue joint writings no later than eight weeks after assignment or as expeditiously as circumstances may permit. Consistent with the general nature of any referee system, the Supreme Court of New South Wales would have the discretion to adopt, vary, or reject the referees' report in whole or in part.

Inasmuch as the judges in New York would not be acting as a court, or in their official adjudicative capaci-

ties, but rather as referees, we avoid the advisory opinion problem. In this regard, the referees' reports will contain a clear disclaimer that they are not intended to serve as official or binding articulations of New York law and do not carry precedential authority. Again, the Supreme Court of New South Wales will be free to give the reports whatever weight, if any, it deems appropriate, although we certainly anticipate that the referees' conclusions will enjoy a strong presumption of reliability.

This judicial referee protocol falls short of the ideal—the kind of direct court-to court assistance embodied in the certified-question procedure. Nonetheless, allowing experienced New York appellate judges to employ their collective expertise, best judgment and discretion to offer answers to questions of New York law still advances our goals significantly, because, quite frankly, the Supreme Court of New South Wales can have great confidence that it is receiving a thorough, reliable report on the status of New York law as provided by a highly credible and neutral source.

It is unclear how frequently this procedure will be invoked. After all, we cannot answer questions of federal law such as bankruptcy and patent and trademark law. But what's important and newsworthy today is that our two judicial systems are committed to working together, in a spirit of comity, and for our mutual benefit, to assist each other in distilling and applying Australian and New York law so that we arrive at the correct and just result.

If nothing else, this agreement serves as a model for the future, and a model for the rest of the world, demonstrating the advantages of cooperation and comity in dealing with the growing number of transnational legal disputes. In the future, such cooperation will be essential to the fair administration of justice around the globe, to the continued growth of international commerce, and to the strengthening of ties between different legal systems and nations.

We should also explore international conventions governing certification of questions of foreign law. As I mentioned previously, there is precedent for such an approach in the British legal tradition. There is a relatively little known model that we can look to here in the United States, the Uniform Certification of Questions of Law Act, first promulgated in 1967 by the Uniform Law Commissioners, which has been helpful to a number of states that adopted certified question procedures.[10] In 1995, there was a little noticed amendment to the Act that expanded the types of courts that may certify a question of law to include the courts of Canada and Mexico. The intent of the amendment was to anticipate the increasingly global legal climate of the approaching 21st century, but as far as my research can determine, this amendment has not been adopted by any state.

I think it is incumbent upon all of us to be creative, and to explore any and all helpful models, including Memoranda of Understanding between individual judicial systems, like the one being signed today, that will allow the courts of different nations to cooperate and assist each other in determining questions of foreign law in a more definitive, efficient and cost-effective manner.

Litigating in a foreign country can be extremely expensive and uncertain. Anything we can do to reduce delay and promote the ability of foreign courts to arrive at predictable results should be encouraged. If our judicial systems fail in achieving these objectives, there will be diminished confidence within the international business community, to the detriment of the global economic order, and certainly to the detriment of our domestic economies.

We all know that international legal disputes are increasing rapidly, and that businesses will continue to expand into foreign markets in order to compete in the global economy. I believe that our judicial systems have a responsibility to accept and respond to these trends so that we are well prepared to meet the changing needs and legitimate expectations of the global legal community.

I want to thank Jim Spigelman for his cooperation, support and flexibility in developing our Memorandum of Understanding. He has impressed me with his encyclopedic knowledge of these issues, and I credit him with raising my consciousness on a topic that I previously had not given enough thought to.

I am delighted to be with him and all of you—if only by video—to memorialize what I think will be recognized as an historic breakthrough in international collaboration between our judiciaries in New York and New South Wales. It is with great pleasure and anticipation that I look forward momentarily to signing the Memorandum of Understanding on behalf of the New York State Judiciary, with Chief Justice Spigelman representing the Supreme Court of New South Wales.

Endnotes

1. Slip opinion no. 09-182, decided 3 Sept. 2010.
2. *Id*. at 9.
3. *Id*. at 15.
4. *Id*. at 18-19.
5. *Id*. at 31.
6. 304 U.S. 64 (1938).
7. Eisenberg, Note, *A Divine Comity: Certification (At Last) in North Carolina*, 58 Duke L.J. 69, 71 (2008).
8. N.Y. Const. art. VI, sec. 3(b).
9. *See* N.Y. Const. art. VI, sec. 20(b).
10. Available at http://www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/ucqla95.pdf.

Jonathan Lippman is the Chief Judge of the State of New York and Chief Judge of the Court of Appeals.

The MOU Between New York and New South Wales

By The Honourable J.J. Spigelman AC

The Chief Judge of New York, Jonathan Lippman, who appears at this Conference by webcast, and I have agreed on the terms of a Memorandum of Understanding to consult and cooperate on questions of law. We will sign this MOU at the end of our presentations to this Plenary Session.

The purpose of the MOU is to create an innovative mechanism for determining a question of law of one jurisdiction that arises in legal proceedings in the other jurisdiction. The traditional mechanism for determining such a question is to treat it as if it were a question of fact and determine it on the basis of expert evidence. This method has numerous inadequacies, including cost and delay. Perhaps most significantly, it will often lead to conclusions that are just plain wrong.

The mutual cooperation mechanism that we are announcing today, which follows a similar MOU between the Supreme Court of New South Wales and the Supreme Court of Singapore announced in June, will, we are both convinced, serve as a model for adoption between additional jurisdictions. If that happens, then the inadequacies of the present system can be ameliorated to a substantial degree.

The multifaceted process called globalization has expanded the scope and range of the cross-border legal issues which can arise in the course of dispute resolution. There will be an increase in the number of cases in which a court will not decline jurisdiction on *forum non conveniens* grounds, even though a question of foreign law must be determined.

Let me illustrate the difficulties that arise in this respect by referring to the resolution of an Australian commercial dispute under a contract governed by New York law.

In the early 1960s, Dr. Lewis Weeks, an American geologist, advised the mining company BHP to search for oil off the southern coast of Australia. His advice was taken and the success of that exploration was the start of a process that transformed a domestic steelmaker into the world's largest mining conglomerate. It led to the discovery of Australia's largest oil field and its major gas field for domestic use.

In consideration for his advice, Dr. Weeks was granted what was described as an "overriding royalty" of two-and-a-half percent of the gross value of all hydrocarbons produced and recovered by BHP and its successors in the relevant area.

Over the course of the next forty years, the exploration permits that BHP originally acquired were converted into different forms of title, some of which were surrendered and reacquired as the prospects of the resource changed.

In 1999, after commencing production in a new area, BHP contended that the words "overriding royalty" had acquired a technical meaning in New York oil and gas law such that royalties were not payable on production from petroleum leases that had been surrendered and reacquired. Dr. Weeks' successor in title, a company called Oil Basins Ltd, contended that the words "overriding royalty" applied to a defined geographic area, and its rights depended only on the production and recovery of hydrocarbons in that area.

Of central significance was a judgment in the Appellate Division of the Supreme Court of New York Court in which the words "overriding royalty" had been interpreted.[1] The parties relied on expert evidence, including that given by two extremely experienced and accomplished New York jurists. Those experts gave diametrically opposite evidence about the applicability of the New York judgment.

One expert for BHP was Judge Howard Levine, who had been a judge for some thirty years, including a decade as an Associate Judge of the Court of Appeals. The expert called on behalf of Oil Basins was Judge Richard Simons, who also had some three decades experience as a judge, including fourteen years as an Associate Judge of the New York Court of Appeals. The tribunal preferred Judge Simons.

This was a commercial arbitration. The arbitral tribunal consisted of two retired Australian judges, who agreed in the result, and an American oil and gas lawyer who dissented. Accordingly, the conflicting opinions of two senior retired American judges had been adjudicated upon, as a finding of fact, by two senior retired Australian judges. The reason that this dispute is known to us, unlike the usual position with commercial arbitrations, is because there was a challenge to the arbitral award on the basis that the tribunal did not give adequate reasons.[2]

The difficulty in expressing the reasons for choosing between the opinions of two equally qualified experts[3] arose because, as a matter of substance, the retired judges on the arbitral tribunal decided the matter as lawyers rather than as deciders of fact. That is to say, the two retired Australian judges decided the issue in the same way as they would decide a question of domestic law. To

regard this process as some sort of factual determination is a fiction.

The example I have chosen involved commercial arbitration. I appreciate that the arrangement that we are announcing today does not extend to that form of dispute resolution. Indeed, in international commercial arbitration there is no such thing as "foreign law." International commercial arbitrators are required to decide the matter before them in accordance with the law applicable to the relevant dispute, which will often not be the law with which the arbitrators are most familiar.

I am convinced that the kind of reference mechanism that we are initiating today can play a useful role, even in the context of arbitration. One of the principal disadvantages that has emerged as a result of the dominance of international commercial arbitration is that the development of legal principles in the law chosen to govern the particular relationship is significantly impeded. Whether it is the law of England or the law of New York, both of which are frequently chosen as the law of international commercial contracts, the fact that so much of the law that is thrown up by contemporary commercial relationships is being determined in arbitral awards that remain confidential is of concern because it prevents the development of commercial law.

The basis of international commercial arbitration is respect for the autonomy of the commercial parties who have chosen to submit their disputes to arbitration. In contexts where commercial law is still developing, it is quite likely that both parties to a particular arrangement will have a mutual interest in the further development of that law. Where that occurs, both parties may consensually wish to have the matter determined on an authoritative and public basis by the courts. It is perfectly consistent with the fundamental principles of international commercial arbitration that an arbitral tribunal can be empowered, at the request of both parties to a dispute, to refer a specific question of law for determination by the relevant court.

Even in the context of court proceedings, where public interest considerations are entitled to override the consensus of the parties, in New South Wales we have decided, at this stage, to proceed only on the basis of the agreement of the parties. This is reflected in the Rules of the Supreme Court of New South Wales which establish a procedure for ordering, with the consent of the parties, that proceedings be commenced in a foreign court in order to answer a question of foreign law that has been identified as being in dispute in proceedings in the NSW Supreme Court.

There is a longstanding alternative mechanism employed in this State for referring the whole, or any part, of proceedings to a referee appointed by the Court. The reports of such referees are brought back to the Court to determine whether the Court will adopt the reasons and orders proposed by the referee. Our Rules now expressly contemplate the reference of a specific question of foreign law to such a referee. This power can be exercised without the consent of the parties, as it reflects a longstanding practice in the Court, albeit not one hitherto used for these kinds of questions.

I envisage that, generally, a referee on a question of foreign law will probably be a senior retired judge from the relevant jurisdiction and will conduct proceedings in that jurisdiction, with the assistance of foreign lawyers appearing for the parties. This alternative procedure is not the subject of any provision in the MOU, since it does not involve judges of a New York court. It would, however, in the normal case, involve New York practitioners.

The Rules of the Supreme Court of New South Wales expressly authorize the Court to exercise its jurisdiction on an issue of Australian law in order to answer a question formulated by a foreign court that arises in proceedings in that Court. We believe that this is permissible under our existing legislation but, to put the matter beyond doubt, I have requested that express provision be made in either the *Supreme Court Act* 1970 or in the *Civil Procedure Act* 2005 to this effect. I understand that there are constitutional limitations upon courts in the United States in this regard, and they will be addressed by Chief Judge Lippman.

Over recent decades an enhanced sense of international collegiality has developed amongst judges. There are many more opportunities for interaction at conferences and on visits by judicial delegations. This has considerably expanded the mutual understanding amongst judges of other legal systems. It has transformed the concept of judicial comity.

Where two legal systems trust each other, the way Australian jurisdictions trust United States jurisdictions, the kind of interaction for which this MOU provides will be readily accepted. I hope, and I believe Chief Judge Lippman agrees, that our initiative will be taken up between each of our courts and other jurisdictions and beyond.

Perhaps somewhat perversely, the expansion of dialogue, interaction and understanding amongst the judges of different nations has reduced the willingness of judges to defer to colleagues overseas simply because of their status. That has occurred as part of the same process, since there has been an increase in the willingness to defer if the other jurisdiction is recognized for its ability and efficiency.

Judges have become more willing, generally at the request of parties in cross-border litigation, to assess the capacity of another legal system which could resolve the dispute. Judges are well placed to assess delays that arise

in another jurisdiction and, with a higher degree of sensitivity, to assess the competence and the integrity of its judges. There are jurisdictions in which the level of corruption amongst the judiciary is known to be high and that is often accepted to be the case even by lawyers from such a jurisdiction.

Particularly in the context of commercial disputes with cross-border elements, judges in the jurisdictions with which I am most familiar approach the issue of whether to assert or decline jurisdiction on the basis of serving the requirements of practical justice in the determination of a particular dispute. We no longer apply, in a technical manner, the rules of the conflicts of laws, let alone a concept of comity based only upon national sovereignty. This trend should be encouraged.

The multiplication of legal disputes which have cross-border elements will require the judiciaries of different jurisdictions to cooperate to a degree that has never hitherto been the case, which I have addressed on earlier occasions.[4] This will encompass a range of forms of interaction between courts, including:

- Assistance with service of process and evidence, particularly pursuant to the provisions of the *Hague Service Convention* 1965 and the *Hague Evidence Convention* 1970.
- Enforcement of judgments, particularly money judgments, pursuant to the existing patchwork quilt of national provisions of variable efficacy.
- Assistance to foreign litigation by the grant of freezing and search orders, to prevent assets from being dissipated and electronic records from being hidden.
- Assistance in the form of interim measures in support of international commercial arbitration, particularly pursuant to the 2006 Revision of the UNCITRAL *Model Law on International Commercial Arbitration*.
- Consideration of harmonious resolution of cross-border insolvency issues, particularly under the system of protocols for court-to-court communications developed pursuant to the guidelines issued by the American Law Institute and the International Insolvency Institute.
- The harmonization of procedure for commercial litigation amongst the major commercial jurisdictions, particularly by following the guidance provided by the Model Principles of Transnational Civil Procedure promulgated jointly by the American Law Institute and UNIDROIT, of which Principle 31 expressly calls for the provision of assistance between courts and which constitutes a workable compromise between the practices of common law and civil law jurisdictions.

There is nothing systematic about these various provisions for judicial cooperation. There is a real need for the development of bilateral and multilateral arrangements which will render it more effective.

The initiative we are announcing today may find wider favor with many jurisdictions that share our view as to the limitations of existing practice with respect to proof of foreign law. This is matter that could well be the subject of international treaties or conventions, whether bilateral or multilateral. In the case of Australia the most likely development of that character will be in the continuing evolution of the treaty arrangements for judicial cooperation between Australia and New Zealand. By reason of our close relationship across the full range of legal interaction, that is the most likely first step to be taken by Australia in this regard. An important precedent exists in the *European Convention on Information on Foreign Law,* which makes express provision for legal questions to be sent from one judiciary to another for answer.

Pending the emergence of new international arrangements, across the full spectrum of matters to which I have referred, we are left with a complete disconnect between the willingness and ability of persons, particularly commercial corporations, to operate and interact across borders in a seamless manner on the one hand, and on the other hand the restrictions that are imposed upon public authorities, both regulatory and judicial, from acting in a similar manner. The freedom of commercial communication and transaction stands in marked contrast to the inhibitions upon communication and transaction between public authorities. Anything that can be interpreted as impacting upon the sovereignty of the nation, by reason of the intrusion of *any* manifestation of the sovereign power of another nation, is subject to restrictions that have been abolished with respect to private actors, even extending to state-owned commercial actors.

One of the barriers to trade and investment, as significant as many of the tariff and non-tariff barriers that have been modified over recent decades, arises from the way the legal system impedes transnational trade and investment by imposing additional and distinctive burdens, including:

- Uncertainty about the ability to enforce legal rights.
- Additional layers of complexity.
- Additional costs of enforcement.
- Risks arising from unfamiliarity with foreign legal process.
- Risks arising from unknown and unpredictable legal exposure.
- Risks arising from lower levels of professional competence, including judicial competence.

- Risks arising from inefficiencies in the administration of justice and, in some cases, from corruption.

These additional transaction costs of international trade and investment are of a character which do not operate, or operate to a lesser degree, with respect to intranational trade and investment. These increased transaction costs impede mutually beneficial exchange by means of trade and investment.

These problems may be ameliorated to a certain extent by the increased sense of collegiality amongst judges from different nations. Understandably, there remains some turf battle considerations between the judges, and their supporting legal professions, who wish to exercise their jurisdiction and keep the legal fees at home, at least in interesting cases. Some nations support their local economy by providing a regulatory or tax haven that is attractive to persons with substantial resources, not least those who have engaged in fraud or corruption. These nations pretend to sell financial services, but their true export industry is the service of opacity.

The MOU we are signing today, even if it comes to be widely adopted, is a small step in ameliorating the disadvantages that the multiplicity of legal systems imposes on international intercourse. It is, I am convinced, a step in the right direction.

Endnotes

1. See *Estate of Hatch v. NYCO Minerals Inc.*, 245 A.D.2d 746, 666 N.Y.S.2d 296 (1997).
2. *BHP Billiton Ltd. v. Oil Basins Ltd.*, [2006] VSC 402; *Oil Basins Ltd. v. BHP Billiton Ltd.,* [2007] VSCA 255; (2007) 18 VR 346.
3. This is not a novel difficulty. *See, e.g., In re Duke of Wellington; Glentanar v. Wellington*, [1947] 1 Ch 506, and on appeal [1947] 1 Ch. 118.
4. See Spigelman, *Transaction Costs and International Litigation*, 80 Austl. L.J. 435 (2006); Spigelman, *International Commercial Litigation: An Asian Perspective*, 37 Hong Kong L.J. 860 (2007) and 35 Austl. Bus. L. Rev. 318 (2007), reprinted in Tim Castle (ed.) Speeches of a Chief Justice: James Spigelman 1998-2008 (2008); Spigelman, *Cross Border Insolvency: Cooperation or Conflict*, 83 Austl. L.J. 44 (2009); Spigelman, *The Hague Choice of Court Convention and International Commercial Litigation*, 83 Austl. L.J. 386 (2009); Spigelman, *Cross Border Issues for Commercial Courts: An Overview*, Address to the Second Judicial Seminar on Commercial Litigation, Hong Kong, 13 Jan. 2010; Spigelman, *Freezing Orders in International Commercial Litigation*, 22 Sing. Acad. L. J. 490 (2010); Spigelman, *The Global Financial Crisis and Australian Courts*, 84 Austl. L.J. 615 (2010). All of these addresses are accessible at www.lawlink.nsw.gov.au/sc under "Speeches."

The Hon. J.J. Spigelman AC is the Chief Justice of New South Wales.

MEMORANDUM OF UNDERSTANDING
BETWEEN
THE CHIEF JUSTICE OF NEW SOUTH WALES
AND
THE CHIEF JUDGE OF THE STATE OF NEW YORK
ON
REFERENCES OF QUESTIONS OF LAW

The Chief Justice of New South Wales and the Chief Judge of the State of New York (hereinafter referred to individually as "the Party" or "each Party" and collectively as "the Parties"):

RECOGNIZING the relationship between the Parties as an important element in promoting and facilitating legal cooperation;

CONVINCED OF the value of close cooperation and consultation for mutual benefit in the field of the administration of justice;

RECOGNIZING the difficulties and costs involved in traditional processes for determining questions of law by the judges of one Party with respect to the law applicable in the jurisdiction of the other Party;

ACKNOWLEDGING the innovative procedure adopted by the Supreme Court of Singapore and the Supreme Court of New South Wales by referring questions of foreign law

HAVE REACHED THE FOLLOWING UNDERSTANDING:

ARTICLE 1

If a substantial legal issue in proceedings before one Court is governed by the law of the other Court, each Party shall give consideration, in accordance with its Rules and procedures, to taking steps to have any such contested issue of law referred to the Party of the governing law for an answer to be provided in accordance with the procedures of the requested jurisdiction.

ARTICLE 2

The consideration referred to in Article 1 may include:

(i) the identification of the precise question of foreign law to be answered;

(ii) the identification of the facts or assumptions upon which the answer to the question is to be determined;

(iii) the identification of whether and, if so, in what respects the Parties may depart from the facts or assumptions and/or vary the question to be answered in any proceedings in the court of the other Party.

ARTICLE 3

Upon the institution of proceedings for the answer to a question pursuant to Articles 1 and 2, each Party undertakes to provide an answer to the referred question of law in accordance with the procedures it has established and as expeditiously as those procedures allow.

ARTICLE 4

In addition to the procedure for assistance and cooperation set forth in Articles 1 and 2, each Party shall take steps to encourage other less formal forms of communication and consultation between the Parties regarding questions of law.

ARTICLE 5

Differences arising from the interpretation, operation and implementation of this Memorandum of Understanding shall be settled amicably through consultation between the Parties based on the principles of mutual understanding and respect.

ARTICLE 6

(i) This Memorandum will come into effect on the date of its signing.

(ii) This Memorandum may be terminated early by either Party giving written notice to the other Party and such termination shall take effect three calendar months after the date of written notice.

(iii) This Memorandum will terminate five calendar years after the date of signing at which time it is anticipated that the procedures herein referred to will be sufficiently well established not to require a succeeding agreement.

Signed on the 27th day of October, 2010 in duplicate

Chief Justice of New South Wales
JJ Spigelman AC

Chief Judge of the State of New York
J Lippman

The New Proposals of the European Commission Regarding the Future of European Investment Treaties: Light at the End of the Tunnel?

By Dr. Lars A. Markert and Alexander Lang

I. Background: The Treaty of Lisbon and the Future of European Bilateral Investment Treaties

On 13 December 2007, the twenty-seven Member States of the European Union ("Member States") signed the Treaty of Lisbon[1] (the "Lisbon Treaty"). After ratification by all Member States, the Lisbon Treaty entered into force on 1 December 2009. The Lisbon Treaty entails changes concerning the institutions and the working methods of the European Union (the "EU") and introduces a single legal personality for the Union that enables the EU to conclude international agreements and join international organizations.

Particularly important for U.S. and other foreign investors active in the EU is that, as a part of its common commercial policy, the Lisbon Treaty transfers the exclusive competence for foreign direct investment ("FDI") from the Member States to the EU. Pursuant to the Lisbon Treaty, only the EU may legislate in this new area of exclusive competence. From the entry into force of the Lisbon Treaty onward, the Member States may act in this regard only if empowered by the EU. Since the Lisbon Treaty does not contain any explicit transitional provisions, this transfer of competence raises many questions with regard to the future treatment of FDI in Europe. Investors from around the world had to be concerned about the validity of the nearly 1,200 bilateral investment treaties ("BITs") concluded between Member States and non-Member States prior to the entry into force of the Lisbon Treaty. Two recent publications by the European Commission (the "Commission") shed some light on how the transition of competence is to be implemented. These publications, however, do not touch upon the status of BITs concluded exclusively between Member States, so-called "intra-EU BITs," a topic which does not concern U.S. investors or other investors from outside the EU and which therefore is not addressed in this article.[2]

II. New Documents Issued by the Commission—the Answer to All Questions?

A. Introduction

In two documents issued at the beginning of July 2010, the European Commission ("the Commission") describes how it aims to assure a smooth transition of the competence in FDI from Member States to the EU while at the same time ensuring that investors obtain standards of protection that are similar to the prior regime contained in Member States' BITs. These documents, a draft EU Regulation and a policy paper, are discussed below.

B. The Draft EU Regulation: Transitional Arrangements for BITs

The first document, a draft EU Regulation (the "Draft Regulation"),[3] proposes to establish "the terms, conditions and the procedure under which Member States are authorized to maintain in force, amend or conclude bilateral agreements with third countries relating to investment."[4] Emphasizing the new exclusive competence of the EU for FDI, the Draft Regulation points out that such authorization of Member States must be regarded as an exceptional transitional measure. Within a period of five years from the entry into force of the Draft Regulation, the Commission will review the need for its continued application.

In the Draft Regulation, the Commission acknowledges that BITs between Member States and non-Member States remain binding under public international law. However, in the long term the Commission aims to replace these BITs by BITs concluded with the EU. In the meantime, the Member States are required to notify the Commission of all BITs with non-Member States. The Commission will review these BITs and consider whether (1) the agreement with the non-Member State conflicts with the laws of the EU; (2) the agreement overlaps, in whole or in part, with an already existing agreement between the respective non-Member State and the EU and the EU agreement does not address the overlap; or (3) the agreement with the non-Member State is incompatible with implementation of the EU's investment policies, in particular the common commercial policy.[5] If a BIT does not pass this three-prong test or if the Council has decided to open negotiations on an agreement that overlaps with the agreement notified to it by the Member State, the Commission will withdraw the Member State's authorization to keep the BIT in force[6]—an authorization generally granted by the Draft Regulation.[7]

The Draft Regulation also provides the procedural framework under which Member States may amend or conclude new BITs. The Draft Regulation notes that by allowing such amendments or new BITs to be concluded it allows Member States to resolve any incompatibilities with the laws of the EU.[8] The authorization to amend existing or conclude new BITs contained in the Draft Regulation is tied to numerous formal and substantial conditions and will only be granted if none of the factors

enumerated in the three-prong test described above applies and if the Council has not decided to open negotiations on an agreement with the non-Member State that overlaps with the agreement amended or newly concluded by the Member State.[9] The process also gives the Commission a say at every stage of the negotiations between a Member State and a non-Member State.[10] Finally, Member States are obliged to inform the Commission of any request for dispute settlement brought against them and to seek the agreement of the Commission before activating any relevant dispute settlement mechanism included in BITs.[11]

Before the Draft Regulation can enter into force, it will need to be passed by the European Parliament and the Council. It remains to be seen whether the Member States will try to use their political influence to achieve more discretion in their handling of BITs concluded with non-Member States.

C. The Policy Paper: Towards a Comprehensive EU Investment Policy?

The second document published by the Commission is a policy paper which outlines how the EU can "develop an international investment policy that increases EU competitiveness"[12] (the "Policy Paper"). According to the Policy Paper, the EU should use its leverage in the negotiations with third countries to achieve favorable terms and an assimilation of investment protection standards so that no EU investor would be worse off than it would be under a Member State's BIT.[13] In the long term, the Commission aims for a situation where investors from the EU and from non-Member States will not need to rely on BITs of one or the other Member State for an effective protection of their investments.

In terms of future negotiating partners, the EU has selected a number of "priority countries." The Commission mentions the possibility of integrating the matter of investment protection into ongoing trade negotiations, whereas the EU has so far only focused on market access for investors. In particular, it refers to negotiations with Canada, India, Singapore and the Mercosur countries. According to the Commission, the EU should also consider stand-alone investment agreements with China and Russia in the short to medium term. Both States have been recognized as offering particular opportunities for European Investors.[14] Negotiations with the U.S. do not seem to be on the agenda so far.

The Policy Paper further expresses which substantive investment protection rules the EU should seek in future agreements. The agreements should contain "best practices" from current BITs of the Member States including provisions on non-discrimination, fair and equitable treatment, full security and protection, as well as an "umbrella clause" (which is a clause providing for the protection of contractual rights granted by a host government to an investor).[15]

Finally the Commission identifies the effective enforceability of investment provisions as a key objective. On the state-to-state level, future investment agreements would be covered by the same state-to-state dispute settlement system that is included in all recent free trade agreements concluded by the EU. Additionally the Commission acknowledges the importance of investor-state dispute settlement as a "key part of the inheritance that the Union receives from Member State BITs."[16] Thus, the Policy Paper suggests that future EU agreements include investor-state dispute settlement provisions.

III. The Unsolved Question: EU Investor-State Arbitration

Before the Commission issued its two publications, investors were especially anxious about the future of investor-state arbitration. Earlier public comments by staff of the Commission gave the impression that the Commission did not want investor-state arbitration clauses in future EU BITs.[17] In the Policy Paper the Commission disperses such doubts and rightfully acknowledges the importance of investor-state arbitration. Moreover, in a related memorandum it states that the "proposed regulation makes it 100% clear that the benefits and rights available under Bilateral Investment Treaties cannot be denied (for example, under investor-state arbitration)."[18]

However, the Commission goes one step further and ties investor-state dispute settlement to a number of policy considerations in order to achieve "state-of-the art investor-state dispute settlement mechanisms."[19] For example, it envisages quasi-permanent arbitrators and an appellate mechanism to achieve consistency and predictability.[20] Also, it aims to introduce more transparency into the arbitral process by providing for open hearings, the admission of amicus curiae briefs and the publication of awards.[21] While these issues will pose some challenges in BIT-drafting and raise questions as to the practicality and the capability of existing institutions to achieve the Commission's goals, they pale in comparison to a number of systemic problems the EU is facing with regard to investor-state arbitration.

By way of example, the International Convention for Settlement of Investment Disputes (ICSID) is only open for signature to states that are members of the World Bank or party to the Statute of the International Court of Justice.[22] Since the EU does not meet either of these requirements, the usual option of having ICSID arbitration provided for in BITs seems on its face to be impossible for a BIT entered into by the EU.[23] Although the Commission intends to explore the possibility of the EU's accession to the ICSID Convention, an amendment of the ICSID Convention allowing for accession of the EU seems to be unrealistic as it would require the consent of every signatory state.[24]

When the EU becomes a respondent in a claim brought under an EU BIT, questions arise about the procedural role of the Member State responsible for the violation of the EU BIT. If the Member State is not made a party to the dispute, it could only intervene as a third party or amicus curiae. While not ideal, the latter should be made easier by the Commission's aims for transparency in investor-state dispute settlement, which includes the participation of amicus curiae in proceedings. Apart from the procedural role of a Member State in claims brought against the EU, it remains to be resolved who would be liable for payment of an award made against the EU in case of violations of a BIT by a Member State.[25]

The Energy Charter Treaty (ECT),[26] which allows for investment arbitration claims against the EU, has so far not yielded any meaningful precedents that could give guidance on these questions.

IV. Conclusion: Increased Legal Certainty but Questions Remain

In the medium term, the transitional arrangements of the Draft Regulation provide legal certainty for investors operating within the EU. The EU has made clear that it is aiming for standards of investment protection that are comparable to current BITs and that the rights and benefits of investors will not be eroded in the future. Nevertheless, investors should observe the developments with interest, since provisions of existing BITs might be declared incompatible with EU law. Parties investing from the "priority states" mentioned above should be especially cautious, as already existing BITs might be superseded. A welcome development is the Commission's clear endorsement of investor-state arbitration. However, questions remain as to how and by whom future disputes will be resolved and as to the role of the Member States in the proceedings.

The Commission qualifies its two documents as mere first steps in the development of a European investment policy and will take into account responses to the proposals embodied in them.[27] Nevertheless, the increased legal certainty created by the Draft Regulation suggests that, for investors from non-Member States, there is indeed light at the end of the tunnel.

Endnotes

1. Treaty of Lisbon Amending the Treaty on European Union and the Treaty establishing the European Community, 13 Dec. 2007, O.J. (C306) 1.
2. In 2006, the Commission expressed that "[t]here appears to be no need for agreements of this [intra EU] kind in the single market and their legal character after accession [of the respective EU Member state to the EU] is not entirely clear. It would appear that most of their content is superseded by Community law." *See* Damon Vis-Dunbar, *EU Members Review Intra-European Bits in Light of Potential Overlap with EU Law*, Investment Treaty News, 30 June 2007, item 4. In line with the statement of the Commission some of the EU Member States have already cancelled intra-EU BITs and others are planning to do so. *See* Luke Erik Peterson, *Italy, Slovenia and Malta Concur with Czech Republic on Lack of Necessity for Intra-EU BITs; Italy-Czech Treaty Has Been Terminated*, 2 Inv. Arb. Rep. item 9 (6 Aug. 2009).
3. Proposal for a Regulation of the European Parliament and the Council establishing transitional arrangements for bilateral investment agreements between Member States and third countries, COM (2010) 344 final (7 July 2010), available at http://trade.ec.europa.eu/doclib/html/146308.htm (last visited on 1 Sept. 2010).
4. *Id*. art. 1.
5. *Id*. art. 5.
6. *Id*. art. 6.
7. *Id*. art. 2.
8. *Id*. recital 11.
9. *Id*. art. 11.
10. *Id*. arts. 7-12.
11. *Id*. art. 13.
12. Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, Towards a comprehensive European international investment policy, at 2, COM (2010) 343 final (7 July 2010), available at http://trade.ec.europa.eu/doclib/html/146307.htm (last visited on 1 Sept. 2010) (hereafter, "Policy Paper").
13. *Id*. at 11.
14. *Id*. at 7.
15. *Id*. at 8.
16. *Id*. at 9.
17. *See, e.g.*, Lars Markert, *5th German Discussion Forum on Investment Law and Arbitration*, SchiedsVZ [German Arb. J.] 222, 223 (2010).
18. European Commission, "Q&A: Commission Launches Comprehensive European International Investment Policy," 7 July 2010), available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=590 (last visited on 1 Sept. 2010).
19. Policy Paper at 19, note 12 *supra*.
20. *Id*. at 10. This contrasts with the current situation under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 18 Mar. 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (hereinafter, the "ICSID Convention") where arbitrators are selected individually for each dispute and where instead of a comprehensive appeals process there is a restricted annulment procedure.
21. Policy Paper at 10, note 12 *supra*.
22. ICSID Convention, note 20 *supra*, art. 67.
23. Tom Toulson, *Will Member States Approve EU Investment Policy?* Global Arb. Rev., 14 July 2010 (on file with author).
24. ICSID Convention, note 20 *supra*, art. 66(2).
25. Policy Paper at 10, note 12 *supra* (indicating that this issue might be addressed by new legislation); Patricia Nacimento, *Who's a Respondent In Light of Art. 207 of the Lisbon Treaty*?, 30 Apr. 2010, available at http://kluwerarbitrationblog.com/blog/2010/04/30/who%e2%80%99s-a-respondent-in-light-of-art-207-of-the-lisbon-treaty/ (last visited on 1 Sept. 2010).
26. 17 Dec. 1994, 2080 U.N.T.S.100, 34 I.L.M. 360 (1995).
27. Policy Paper at 11, note 12 *supra*.

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The Impact of *Morrison v. National Australia Bank* on RICO's Extraterritorial Reach

By David E. Miller

I. Overview

On 24 June 2010, the Supreme Court of the United States issued *Morrison v. National Australia Bank Ltd.* ("*Morrison*"),[1] in which the Court held that the Securities Exchange Act does not apply extraterritorially, *i.e.*, to conduct in countries other than the United States.[2] While the Court did not address the issue directly, its reasoning in *Morrison* also applies to claims brought pursuant to the Racketeering Influenced and Corrupt Organizations Act ("RICO"). As a result, *Morrison* appears to have eliminated many potential RICO claims, as well as the ability to seek treble damages pursuant to those claims.

The potential impact of *Morrison* on RICO claims arising from conduct outside the United States is already apparent. On 28 September 2010, the U.S. Court of Appeals for the Second Circuit (the "Second Circuit") affirmed a district court decision dismissing a RICO action on the ground that *Morrison* precludes extraterritorial RICO claims.[3] As of October 2010, no other circuit court of appeals had considered that issue.

II. RICO's Extraterritorial Reach Prior to *Morrison*

The RICO statute is silent as to its extraterritoriality.[4] Prior to *Morrison*, those circuit courts of appeals that considered the issue of RICO's extraterritorial reach generally took the view that "RICO may apply extraterritorially if conduct material to the completion of the racketeering occurs in the United States or if significant effects of the racketeering are felt here."[5] These "conduct" and "effects" standards were derived from precedents arising from international securities transactions and antitrust matters.[6]

With respect to transnational securities frauds, the courts' analyses focused on whether either a "conduct" test or an "effects" test had been satisfied.[7] The "conduct" test focused on how conduct within the United States related to the alleged fraudulent scheme, "on the theory that Congress did not want to allow the United States to be used as a base for manufacturing fraudulent security devices, even when these are peddled only to foreigners."[8] Under this test, a foreign party could bring a claim pursuant to the securities laws only if conduct within the United States "directly caused" such a party's loss abroad.[9] However, with respect to the "conduct" test, a split emerged among the circuits regarding the level of domestic conduct necessary to establish subject matter jurisdiction for federal securities fraud claims brought by foreign investors in foreign stock.[10]

The alternative "effects" test implemented Congress's purported intent that the securities laws be given extraterritorial application "in order to protect domestic investors who have purchased foreign securities on domestic exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities."[11] Thus, "the United States prohibition of securities fraud [could] be given extraterritorial reach whenever a predominately foreign transaction [had] substantial effects within the United States."[12] Transactions with only remote and indirect effects in the United States were deemed insufficient.[13]

In the antitrust context, the analysis proceeded along similar lines, but emphasized the effects of the relevant conduct in the United States, as opposed to where that conduct took place.[14] More specifically, antitrust laws, such as the Sherman Act, were held to be enforceable against foreign entities participating in illegal combinations within the United States and also against foreign entities whose anticompetitive conduct occurred outside the United States but had consequences here, so long as the conduct was intended to and actually did affect United States imports or exports.[15] As the Second Circuit noted, the latter "effects-oriented approach[, which was] borrowed from antitrust cases [seemed] an equally or even more appropriate test" because "the civil action provision of RICO was patterned after the Clayton Act. Moreover, RICO (like the antitrust laws) provides for treble damages, which heightens concerns about international comity and foreign enforcement."[16]

In the absence of a single, clear test, district courts tended to blend the two tests together and hold that RICO applied extraterritorially if either a "conduct" or "effects" test had been met.[17] In some cases, courts held that one test, but not the other, had been met.[18]

III. *Morrison*

Morrison was brought by investors who had bought shares in National Australia Bank Limited ("National").[19] Those shares were not traded on any exchange in the United States.[20] However, National's American Depositary Receipts ("ADRs") were available for purchase on the New York Stock Exchange.[21] Each ADR represented the right to receive a specified number of National's shares.[22] In 1998, National acquired HomeSide Lending, Inc. ("HomeSide"), a mortgage servicing company based in Florida.[23] HomeSide published certain financial statements and made other, public statements regarding its financial success.[24] Between 1998 and 2001,

National's annual reports and other public documents also touted the success of HomeSide's business.[25] In 2001, National announced that it was writing down the value of HomeSide's business by $2.2 billion.[26] Not surprisingly, the prices of National's shares and ADRs slumped.[27] Three Australian citizens, who had bought National's shares before the writedown, sued National, HomeSide, and four executives from National and HomeSide in the United States District Court for the Southern District Court of New York, alleging violations of Sections 10(b) and 20(a) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5.[28]

Defendants moved to dismiss for lack of subject matter jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(1) and for failure to state a claim under Rule 12(b)(6).[29] The District Court granted defendants' motion pursuant to Rule 12(b)(1), and the Second Circuit affirmed.[30] Both courts held that any acts performed in the United States were peripheral to the alleged overall fraud scheme.[31] The Supreme Court granted certiorari to determine whether "Section 10(b) of the Securities Exchange Act provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges."[32]

In a scathing opinion, Justice Scalia first found that the Second Circuit had made a fundamental error in finding that Section 10(b) of the Securities and Exchange Act could *ever* apply to acts outside the United States:

> It is a longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States. This principle represents a canon of construction, or a presumption about a statute's meaning, rather than a limit upon Congress' power to legislate. It rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters. Thus, unless there is the affirmative intention of the Congress clearly expressed to give a statute extraterritorial effect, we must presume it is primarily concerned with domestic conditions. The canon or presumption applies regardless of whether there is a risk of conflict between the American statute and a foreign law. *When a statute gives no clear indication of an extraterritorial application, it has none*.[33]

Justice Scalia then went on to trace the development of case law in the Second Circuit, which had led that court to conclude that Securities and Exchange Act Section 10(b) could be applied in situations involving wrongful conduct that either (a) had a substantial effect in the United States or on United States citizens (the "effects" test) or (b) occurred in the United States (the "conduct" test).[34] Justice Scalia noted that other circuit courts of appeals had "embraced" the Second Circuit's approach, although not its precise application.[35] Rather, he suggested, those courts had produced a plethora of "vaguely related variations on the 'conduct' and 'effects' tests."[36] Following an extended discussion of related issues, Justice Scalia rendered the opinion of the Court:

> Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States. This case involves no securities listed on a domestic exchange, and all aspects of the purchases complained of by those petitioners who still have live claims occurred outside the United States. Petitioners have therefore failed to state a claim on which relief can be granted. We affirm the dismissal of petitioners' complaint on this ground.[37]

It is difficult to overstate the likely impact of *Morrison* on securities fraud cases. *Cornwell v. Credit Suisse Group* ("*Cornwell*")[38] is illustrative. *Cornwell* concerned a complaint alleging securities fraud against defendants based on plaintiffs' purchases of shares in Credit Suisse Global ("CSG") either on the Swiss Stock Exchange ("SWX") or as American Depositary Shares on the New York Stock Exchange.[39] On 6 July 2010, defendants moved by letter for a partial judgment on the pleadings seeking dismissal of claims brought by U.S. residents who had purchased CSG shares on the SWX.[40] Letter briefs from each party were submitted to the Court on 19 July 2010.[41] Just over a week later, the court granted defendants' motion on the ground that *Morrison* had definitively laid to rest the "conduct" and the "effects" tests for determining the extraterritorial reach of Section 10(b) of the Securities and Exchange Act:

> In *Morrison,* the Supreme Court roundly (and derisively) buried the venerable "conduct or effect" test the Second Circuit devised and for years had employed to determine whether the protections and remedies contained in § 10(b) of the Exchange Act apply extraterritorially to reach fraudulent securities transactions abroad under the facts of a case. Yet here, Plaintiffs seek to exhume and revive the body. They argue that § 10(b) claims by investors such as [the Louisiana Municipal Police Employees

Retirement Systems] survive *Morrison* on the grounds that such plaintiffs are American citizens, and that some aspects of the foreign securities transactions at issue occurred in the United States. This Court is not persuaded. As this Court reads *Morrison,* the conduct and effect analysis as applied to § 10(b) extraterritoriality disputes is now [a] dead letter. Plaintiffs' cosmetic touch-ups will not give the corpse a new life. The standard the *Morrison* Court promulgated to govern the application of § 10(b) in transnational securities purchases and sales does not leave open any of the back doors, loopholes or wiggle room to accommodate the distinctions Plaintiffs urge to overcome the decisive force of that ruling on their § 10(b) claims here.[42]

In reaching this conclusion, the *Cornwell* court also rejected plaintiffs' argument that *Morrison* applies only to claims brought in connection with foreign securities purchased by foreign parties on a foreign exchange: "[H]ad the majority confined its ruling strictly to the facts presented, it would have been unnecessary for it to stretch outside the bounds of the case so as to trash the Second Circuit's conduct and effect doctrine so unceremoniously and then fashion an entirely new rule cut out of whole cloth."[43]

Since *Cornwell*, other courts in the Southern District of New York have had little difficulty dismissing securities fraud claims based on Justice Scalia's opinion in *Morrison*.[44]

The Dodd-Frank Wall Street Reform and Consumer Protection Act, which was signed into law by President Obama on 21 July 2010, partially reverses *Morrison* by giving federal courts jurisdiction over suits brought by the Securities and Exchange Commission and the federal government arising from both (a) "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors" and (b) "conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[45] Pursuant to that new legislation, the SEC is required to study the extent to which private rights of action should be extended to include securities fraud arising from those same categories of conduct.[46]

IV. *Morrison's* Impact on Pending and Future RICO Litigation

The impact of *Morrison* on pending and future RICO litigation is also far-reaching. Consider, for example, *Norex Petroleum Ltd. v. Access Industries, Inc.* ("*Norex*").[47] In *Norex*, plaintiff claimed that it was deprived of its majority ownership stake in a Russian oil company, Yugraneft, and of certain quantities of oil owed to it by Yugraneft and other Russian oil entities, through a series of unlawful actions, including bribery of Russian public officials and corrupt Russian bankruptcy proceedings.[48] Plaintiff alleged that defendants had committed numerous predicate acts of racketeering within the United States.[49] The District Court dismissed this action on the basis that plaintiff had not met, and could not meet, any of the tests devised by the Second Circuit for the extraterritorial application of RICO.[50] Plaintiff appealed.[51] The Second Circuit subsequently requested that the parties submit briefs concerning the impact of *Morrison* on plaintiffs' appeal of the District Court's decision.[52]

In their Supplemental Brief, the plaintiff-appellant argued, *inter alia*, that the Second Circuit should consider RICO's text, Congress' intent, and the context in which RICO applies.[53] With respect to the first argument, plaintiff-appellant argued that RICO is distinguishable from § 10(b) because (a) RICO applies to "any enterprise which is engaged in, or the activities of which affect, interstate *or foreign commerce*"; (b) RICO makes it illegal to engage in racketeering activity, which specifically includes twenty-five predicate acts that facially apply to extraterritorial conduct; and (c) unlike § 10(b), RICO contains no language that restricts it domestically.[54] Plaintiff-appellant also directed the Second Circuit to language in RICO's legislative history that tended to show concern with international criminal activity.[55] Finally, the plaintiff-appellant argued that civil RICO is meant to complement criminal RICO, and that criminal statutes are, as a rule, read to apply extraterritorially.[56]

In their Supplemental Brief and Supplemental Reply Brief, defendants-appellees relied heavily on the text of *Morrison* to rebut plaintiff-appellant's arguments. (The plaintiff-appellant opted not to submit a reply brief.) With respect to RICO's text, the defendants-appellees pointed out language in *Morrison* to the effect that "even statutes …that expressly refer to 'foreign commerce' do not apply abroad."[57] Defendants-appellees also noted that, under *Morrison*, the extraterritorial reach of certain predicate acts does not provide a basis for extending RICO itself extraterritorially.[58] Finally, defendants-appellees argued that, like § 10(b), RICO is silent about punishing RICO injuries sustained abroad to the non-U.S. holdings of non-U.S. parties.[59] Defendants-appellees also made short work of plaintiff-appellant's arguments concerning Congressional intent[60] and the criminal context.[61]

Citing *Morrison* at every turn, the Second Circuit rejected each of plaintiff-appellant's arguments for several of the reasons advanced by the defendants-appellees:

> First, Norex argues that RICO § 1962(a)-(d) applies to "any enterprise which is engaged in, or that activities of which affect, interstate or foreign commerce."

> *Morrison* forecloses that argument, noting that "we have repeatedly held that even statutes that contain broad language in their definitions of commerce do not apply abroad." http://web2.westlaw.com/find/default.wl?referencepositiontype=S&serialnum=2022366653&referenceposition=2882&rp=%2ffind%2fdefault.wl&sv=Split&rs=WLW10.10&db=708&tf=-1&findtype=Y&fn=_top&mt=Westlaw&vr=2.0&pbc=85BD5699&tc=-1&ordoc=2023159581*Morrison* similarly forecloses Norex's argument that because a number of RICO's predicate acts possess an extraterritorial reach, RICO itself possesses an extraterritorial reach. Finally, contrary to Norex's claims, simply alleging that some domestic conduct occurred cannot support a claim of domestic application. "[I]t is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States."[62]

It is thus now quite clear that the Second Circuit's prior jurisprudence concerning the applicability of the "conduct" test and/or the "effects" test—as derived from prior securities-related case law—to determine the extraterritoriality of RICO is now, to use the words of the *Cornwell* court, "a dead letter." Similarly, while the issue was not before the *Morrison* court, it appears that the Second Circuit's prior case law concerning the applicability of a similar "effects" test—as derived from prior Sherman Act jurisprudence—is also unlikely to survive *Morrison*.

On 23 July 2010, British American Tobacco (Investments) Limited ("BATCo") filed a petition for rehearing with the Supreme Court, asking that, in light of *Morrison*, the Court grant rehearing of its prior order denying BATCo's petition for a writ of certiorari.[63] On 3 September 2010, the Court denied that petition.[64] If, as may happen, other circuits decline to apply *Morrison* to RICO claims, then it seems likely that this issue will be back before the Supreme Court. It remains to be seen whether RICO's extraterritorial wings have been permanently clipped.

Endnotes

1. 130 S. Ct. 2869 (2010).
2. *Id.* at 2877-78.
3. *Norex Petroleum Ltd. v. Access Indus., Inc.*, Docket No. 07-4553-cv, 2010 WL 3749281 (2d Cir. 28 Sept. 2010).
4. *Poulos v. Caesars World*, 379 F.3d 654, 663 (9th Cir. 2004); *North South Finance Corp. v. Al-Turki*, 100 F.3d 1046, 1051 (2d Cir. 1996). Note that, while this issue is typically raised on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(2) (lack of subject matter jurisdiction), the Supreme Court's decision in *Morrison* suggests that it is more properly raised pursuant to Fed. R. Civ. 12(b)(6) (failure to state a claim). *Morrison*, 130 S. Ct. at 2876-77.
5. *Liquidation Comm'n of Banco Intercontinental, S.A. v. Renta*, 530 F.3d 1339, 1351-52 (11th Cir. 2008) (citing *North South Finance Corp.*, 100 F.3d 1046, at 1051, (2d Cir. 1996) and *Poulos*, 379 F.3d 654, at 663-64 (9th Cir. 2004)).
6. *North South Finance Corp.*, 100 F.3d 1046, at 1051 (2d Cir. 1996).
7. *Id.*
8. *Id.*
9. *Id.*
10. *In re Banco Santander Secs.–Optimal Litig.*, Nos. 09-MD-02073-CIV, 09-CV-20215-CIV, 2010 WL 3036990, at *5 (S.D. Fla. 30 July 2010).
11. *North South Finance Corp.*, 100 F.3d 1046, at 1051 (2d Cir. 1996).
12. *Id.*
13. *Id.*
14. *Id.*
15. *See id.* at 1051-52. *Cf.* 15 U.S.C. § 6(a) (limiting extraterritorial reach of Sherman Act to conduct having a "direct, substantial, and reasonably foreseeable effect" in the United States).
16. *Id.* at 1052.
17. *See Rep. of Colombia v. Diageo N. Am. Inc.*, 531 F. Supp. 2d 365, 419-20 (E.D.N.Y. 2007) (gathering cases).
18. *See*, *e.g.*, *Liquidation Comm'n of Banco Intercontinental, S.A. v. Renta*, 530 F.3d 1339, at 1352 (11th Cir. 2008) (where no United States person or business had been injured by alleged scheme, effects test had not been met, but subject matter jurisdiction existed because extensive conduct in consummation of RICO conspiracy had occurred in the United States).
19. *Morrison v. Nat'l Australia Bank Ltd*, 130 S. Ct. 2869, at 2876 (2010).
20. *Id.* at 2875.
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.* at 2875-76.
25. *Id.* at 2875.
26. *Id.* at 2875-76.
27. *Id.* at 2876.
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.* at 2875.
33. *Id.* at 2877-78. (Internal citations and quotations omitted.) (Emphasis added.)
34. *Id.* at 2878-79.
35. *Id.* at 2880.
36. *Id.*
37. *Id.* at 2888.
38. No. 08 Civ. 3758, 2010 WL 3069597 (S.D.N.Y. 27 July 2010).
39. *Id.* at *1.
40. *Id.*
41. *Id.*
42. *Id.* at *2.
43. *Id.* at *5.

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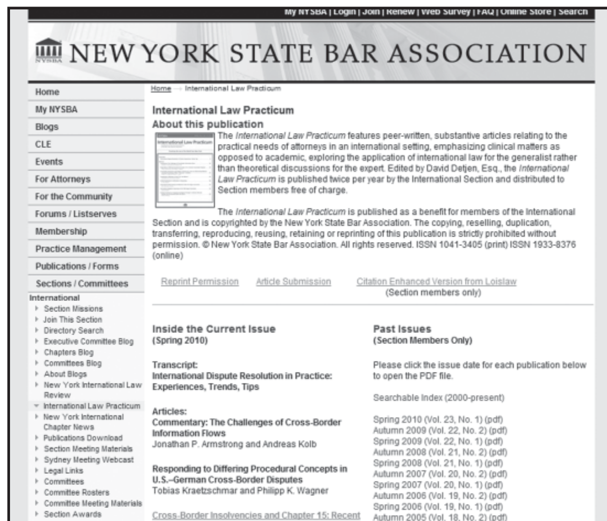

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44. *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, No. 08 Civ. 1958, 2010 WL 3860397 (S.D.N.Y. 4 Oct. 2010); *In re Société Générale Secs. Litig.*, No. 08 Civ. 2495, 2010 WL 3910286 (S.D.N.Y. 29 Sept. 2010); *In re Alstom SA Secs. Litig.*, No. 03 Civ. 6595, 2010 WL 3718863 (S.D.N.Y. 14 Sept. 2010); *Terra Secs. ASA Konkursbo v. Citigroup, Inc.*, No. 09 Civ. 7058, 2010 WL 3291579 (S.D.N.Y. 16 Aug. 2010); *Sgalambo v. McKenzie*, No. 09 Civ. 10087, 2010 WL 3119349 (S.D.N.Y. 6 Aug. 2010) (all dismissing securities fraud claims pursuant to *Morrison*).
45. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, Section 929P(b), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf.
46. *Id.*, Section 929Y.
47. 540 F. Supp. 2d 438 (S.D.N.Y. 2007).
48. *Id.* at 440.
49. *Id.*
50. *Id.* at 443.
51. *See Norex Petroleum Ltd. v. Access Indus., Inc.*, 620 F. Supp. 2d 587, 588 (S.D.N.Y. 2009) (noting that Norex's first amended complaint was dismissed and that the parties were awaiting that court's decision on the appeal).
52. Order, issued by the United States Court of Appeals for the Second Circuit in *Norex Petroleum Ltd. v. Access Indus., Inc.*, 07-4553-cv, dated 23 July 2010 (copy on file with author).
53. Supplemental Brief for Plaintiff-Appellant, *Norex Petroleum Ltd. v. Access Indus., Inc.*, 07-4553-cv, submitted on 23 Aug. 2010 (copy on file with author).
54. *Id.* at 2-3. (Emphasis in original.)
55. *Id.* at 4.
56. *Id.* at 4-5.
57. Supplemental Brief for Defendants-Appellees, *Norex Petroleum Ltd. v. Access Indus., Inc.*, 07-4553-cv, submitted on 23 August 2010 ("Defs. Supp. Br.") (copy on file with author) at 5 (quoting *Morrison*, 130 S. Ct. at 2882); Supplemental Reply Brief for Defendants-Appellees, *Norex Petroleum Ltd. v. Access Indus., Inc.*, 07-4553-cv, submitted on 8 September 2010 ("Defs. Supp. Rep. Br.") at 2 (same) (copy on file with author).
58. Defs. Supp. Br. at 5-6 (citing *Morrison*, 130 S. Ct. at 2883 n.8 and 2887-88); Defs. Supp. Rep. Br. at 2 (citing *Morrison*, 130 S. Ct. at 2882-83).
59. Defs. Supp. Br. at 6-7; Defs. Supp. Rep. Br. at 1-2 (citing *Morrison*, 130 S. Ct. at 2883).
60. Defs. Supp. Br. at 3-4 (citing *Morrison*, 130 S. Ct. at 2887-88) and 5 (citing *Morrison*, 130 S. Ct. at 2883 n. 8); Defs. Supp. Rep. Br. at 2 (citing *Morrison*, 130 S. Ct. at 2882).
61. Defs. Supp. Rep. Br. at 3 (citing *Morrison*, 130 S. Ct. at 2885).
62. *Norex Petroleum Ltd. v. Access Indus., Inc.*, Docket No. 07-4553-cv, 2010 WL 3749281 (2d Cir. 28 Sept. 2010) (internal citations and parenthetical comments omitted).
63. *British Am. Tobacco (Invs.) Ltd v. U.S.*, Petition for Rehearing, No. 09-980, filed on 23 July 2010, available at http://www.scotusblog.com/wp-content/uploads/2010/07/BATCo-rehear-July-2010.pdf.
64. *See* Docket Sheet, available at http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/09-980.htm.

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The Developing U.S. Law Regarding the Invisible Use of the Trademarks of Others in Cyberspace

By L. Donald Prutzman

I. Introduction

The explosive growth of the Internet and the World Wide Web over the past fifteen years has enabled, and fueled, an entirely new phenomenon implicating trademark protection law—the ability to promote goods and services by using the trademarks of others, usually competitors, invisibly as part of the unseen data that is incorporated into every Internet Web site. Because of the introduction of this ability, trademark protection law has had to address new questions concerning whether the invisible use of trademarks belonging to others infringes the rights of those trademark owners. As discussed in more detail below, the answers to these questions are not obvious based on straightforward application of existing trademark law developed in the context of trademarks that are visible or at least perceived by one of the human senses. No legislative guidance from Congress has attempted to provide answers, and so the federal courts of the United States have had to work to generate the answers using the case-by-case decision making process that characterizes the workings of the judicial branch of the federal government.

Thus, the federal courts have been charged with working out whether, and if so, how, preexisting concepts of trademark law should be applied to these new ways of using trademarks, which some see as fair and beneficial to society and others see as a pernicious invasion of trademark owners' rights and commercial interests. In other words, the courts have had to determine whether new wine should be put in old bottles or whether new packaging should be created for it.

This is not a new task for the federal courts. A number of past technological innovations—the telephone, motion pictures, talking pictures, television, video cassette players, digital recording and computer file sharing, among others—have presented similar challenges in molding intellectual property protection to accommodate them. As discussed below, the process of accommodating invisible trademarks has taken several interesting twists and turns and inconsistent approaches among courts and is not yet finished. However, it is coming into sharper focus.

II. Invisible Uses of Trademarks in Cyberspace

A. Common Theme: No Perceived Use

Although there are always variations, and more variations will doubtless arise, there are three principal contexts in which the "invisible" use of trademarks of others on the Internet arises. The common theme is that, although someone else's trademark is used, the Internet-user does not perceive any use of a trademark.

B. Trademark Use in Metatags

Internet Web sites have nonvisual, electronic information associated with them known as "metatags" or "metadata." Among other uses, search engines comb through metadata to return search results to the user. The metadata can describe the subject matter of a Web site so that the site will be returned in the search when a user searches for that subject matter. For example, the operator of a Web site about Magna Carta would want to include terms in metadata such as Magna Carta, Runnymeade, King John, and the like, so that the site would be returned when a user searched for those terms. If a Web site operator sells or promotes trademarked products or services via a Web site it would obviously be a good idea to put the trademark in the site's metadata. It might also seem a good idea to the operator to put competitors' trademarks in the metadata so that when a user searched for Web sites offering the competitors' products or services, the search results would present the site operator's goods or services as an alternative. For example, in theory ADIDAS might like to put NIKE in its metatags so that potential customers searching for "Nike" would also get a link to the ADIDAS Web site. For obvious reasons, Nike would cry foul.

C. "Keyword" Use of Trademarks

As an alternative to Web site operators putting information in Web site metatags, search-engine operators can sell information as "keywords" to trigger the appearance of advertisements or additional search results in response to searches that include the purchased keyword. As a benign example, a search engine could sell the keyword "train rides" to the operator of a tourist railroad, which would cause an advertisement or a link for the tourist railroad to appear in the search results when a user searched for train rides. As a more potentially troublesome example, a business could purchase a competitor's trademark as a keyword. This would cause the search engine to display the business's Web site or an ad for its products when the user searched the competitor's trademark. It is up to the search-engine operator whether the material returned as a result of the keyword is or is not clearly distinguishable from the "genuine" search results, i.e., the results that would have been returned absent the keyword sale. It would also not be known whether the user in a given instance was searching specifically for the

trademark owner's goods or services or was interested in learning about alternative sources for the goods or services.

D. Use of Trademarks to Trigger "Pop-Up" Ads

Companies not operating search engines but nevertheless selling Internet advertising can use trademarks as triggers for advertising. Generally called "pop-up ads," this form of advertising is often generated by "free software" that the user downloads to his or her computer. The user often does not realize that the wonderful free software he or she is getting also includes pop-up ad generation. Really, the software is not "free," it is just advertiser-supported. In addition to doing whatever it does that the user wanted it for, the software monitors the user's Internet activity and generates a pop-up ad when triggered by use of a "keyword." Thus, FORD could purchase BUICK as a keyword from a pop-up advertising company and cause a pop-up ad for FORD to be generated when the user was looking for information about BUICK. Current technology allows the same ad to pop up again and again, seemingly following the user around the Internet. The theory is that the more the ad is viewed, the more likely the user is to purchase the good or service.

III. Differing Views on Whether Invisible Use of Trademarks of Others Infringes the Legitimate Rights of the Trademark Owner

Obviously, trademark owners feel that others' use of their trademarks—even invisibly—to promote others' goods or services is abusive. Those who have a more global outlook are not so sure. There are two competing sets of policy considerations.

To trademark owners, and some others, invisible use of a competitor's trademark to attract attention to one's own goods or services in addition to the competitor's goods or services "free rides" on the substantial investment of time, effort and money that the trademark owner has made in establishing and building goodwill in the trademark. It effectively reaps where the competitor did not sow. It allows the competitor to divert the attention of those seeking a particular brand of goods or services, and, if not clearly presented as an alternative, may deceive the customer concerning the origin of the competitor's goods. It is akin to erecting a sign saying that the brand the user is seeking is available at a given location when, in fact, if the user shows up at that location, he will only be offered a competing brand.

To those concerned with broader policy implications and consumer welfare, invisible use of a competitor's trademark in the ways discussed above tends to provide the consumer with a greater range of choices for a product or service and may offer the consumer a better or cheaper alternative that he or she did not realize was available. This group would urge that these pro-consumer aspects outweigh any unfairness to the trademark owner. They would argue that consumers who express online interest in a good or service by using a trademark may only be using the trademark as a shorthand way of referring to the good or service the trademark represents and are interested in getting information on all alternatives. They would also argue that the Internet presentation of "triggered" or "sponsored" alternative goods or services to the consumer is not functionally different from what occurs when a consumer enters a retail store looking for a specific brand and finds it on the shelf next to competing brands that may attract the consumer's attention and offer better value. To this group, as long as the information is not presented in a way that misleads the consumer into believing that the products or services come from the owner of the trademark they used in their search, the consumer is benefited and the practice should be permitted.

One leading commentator has noted the following in regard to trademarks sold as keywords:

> [T]he portals and search engines are taking advantage of the drawing power and goodwill of these famous marks. The question is whether this activity is fair competition or whether it is a form of unfair free riding on the fame of well-known marks.[1]

As will become clear below, courts considering whether invisible use of trademarks is infringing will grapple with these competing considerations.

IV. The Two Types of Potential Infringers

Trademark owners who wish to challenge the invisible use of their trademarks have proceeded in two directions.

Some have proceeded directly against the company using the trademark in metatags or purchasing the trademark as a keyword, on theories of direct trademark infringement. This approach, if successful, will, of course, stop only one competitor at a time.

Others have proceeded against the search-engine operator or pop-up advertising service that sells the trademark as a "keyword" or "trigger." The theories here include contributory infringement and inducing infringement. If successful, this approach will obviously achieve quicker, more effective results as it will halt the practice involved, not just individual users of it.

V. Development of U.S. Law on Invisible Trademarks

A. Use of Trademarks of Others in Web Site Metatags

The first cases to consider invisible use of trademarks arose in the context of metatag use. Trademark

owners sued Web site operators alleging that use of the plaintiff's trademark in Web site metatags infringed the trademark. The first widely publicized decision was the Ninth Circuit's[2] decision in *Brookfield Communications, Inc. v. West Coast Entertainment Corp.*[3] In that case both parties offered competing computer software and database information concerning motion pictures and the movie industry. Brookfield Communications, which marketed its product under the trademark MOVIE BUFF, sought a preliminary injunction, inter alia, against West Coast Entertainment's use of that mark in the metatags of its Web site offering its competing product. The court reversed the lower court's denial of an injunction, finding that the metatag use of the trademark infringed Brookfield's MOVIE BUFF trademark. The court did not consider the issue of whether invisible metatag use constituted "use" for purposes of the Lanham Act,[4] the primary trademark law of the United States. As discussed below, this issue only later emerged as a key issue.

Without deciding the "use" issue, the court found that the metatag use infringed the plaintiff's trademark by causing initial interest confusion. Although it found that consumers led to the defendant's Web site through the metatag would likely realize that it was not the plaintiff's Web site, they would still find there a database similar enough to the plaintiff's, "such that a sizeable number of consumers who were originally looking for Brookfield's product will simply decide to utilize West Coast's offering instead." Thus, "by using 'Movie-Buff' to divert people looking for 'Movie-Buff' to its Web site, West Coast improperly benefits from the goodwill that Brookfield developed in its mark."

In what has become an oft-quoted brick and mortar analogy, the court stated the following:

> Using another's trademark in one's metatags is much like posting a sign with another's trademark in front of one's store. Suppose West Coast's competitor (let's call it "Blockbuster") puts up a billboard on a highway reading—"West Coast Video: 2 miles ahead at Exit 7"—where West Coast is really located at Exit 8 but Blockbuster is located at Exit 7. Customers looking for West Coast's store will pull off at Exit 7 and drive around looking for it. Unable to locate West Coast, but seeing the Blockbuster store right by the highway entrance, they may simply rent there. Even consumers who prefer West Coast may find it not worth the trouble to continue searching for West Coast since there is a Blockbuster right there. Customers are not confused in the narrow sense: they are fully aware that they are purchasing from Blockbuster and they have no reason to believe the Blockbuster is related to, or in any way sponsored by, West Coast. Nevertheless, the fact that there is only initial interest consumer confusion does not alter the fact that Blockbuster would be misappropriating West Coast's acquired goodwill.[5]

Four years later, in *Horphag Research Ltd. v. Pellegrini,*[6] the Ninth Circuit again considered whether the use in metatags of a competitor's trademark was infringing. Without much analysis of whether the confusion was merely initial confusion or whether the consumer might actually purchase the defendant's product believing it was the plaintiff's, and with no consideration of whether invisible use was cognizable "use" under the Lanham Act, the court followed *Brookfield* and found infringement.

In 2006, the Tenth Circuit Court of Appeals[7] considered the metatag use of another's trademark in a slightly different context in *Australian Gold, Inc. v. Hatfield*.[8] In that case, the defendant was an unauthorized retailer of the plaintiff's indoor tanning lotions. The plaintiff sought to limit sellers of its products to its authorized retailers but the defendant managed to obtain genuine Australian Gold products through unauthorized channels and offer them on its Web site. The defendant used the plaintiff's trademark, among other ways, in its Web site's metatags. It did so, not only while it was offering the plaintiff's products on its Web site, but it also left the trademark in the metatags during certain periods when it was not offering the plaintiff's products on its site. The court affirmed the lower court's holding that the metatag use constituted infringement. Unfortunately, the court did not distinguish between the metatag use while the defendant sold the plaintiff's products and the metatag use while the defendant did not. It held that use during both periods was infringing.

Although the infringement finding with respect to metatag use while the defendant did not offer the plaintiff's products is merely a straightforward application of *Brookfield,* the court's lumping that together with periods during which the defendant did sell the plaintiff's products is troubling. If the defendant is offering the plaintiff's genuine products, even though as an unauthorized distributor, why should the defendant be barred from "advertising" that fact through metatag use? An Internet user searching the plaintiff's trademark presumably would want to find sites where genuine products could be purchased, whether or not the seller was an authorized distributor. Although the court noted that ordinarily a seller of genuine goods is allowed to use the trademark to advertise those goods, whether the trademark owner authorizes it or not, the court reasoned that the metatag use of the trademark somehow constituted a representation that the defendant was more than just a seller of the plaintiff's products, that it was an authorized distributor. There seems little to support that reasoning and little to support

the notion that metatag use of a trademark is anything more than the equivalent of print advertising that the plaintiff's products can be obtained at the defendant's Web site. To this extent, one could well conclude that the *Australian Gold* court reached the wrong result. And, as in *Brookfield*, no consideration was given to whether invisible use of trademarks constituted "use" under the Lanham Act.

In another 2006 case, *Tdata, Inc. v. Aircraft Technical Publishers*,[9] the court followed *Brookfield* in holding that use of a competitor's trademark invisibly in Web site metatags was trademark infringement because it was likely to cause initial interest confusion.

Thus, subject to consideration of the issue discussed below of whether the invisible use of trademarks constitutes Lanham Act "use," it seems fairly well established that metatag use of a competitor's trademark to attract attention to a Web site selling competitive products, or even the trademark owner's products, without the trademark owner's authorization, will be held to be trademark infringement.

B. Use of Others' Trademarks as "Keywords" and to Generate Advertising

The appellate decision in *Playboy Enters., Inc. v. Netscape Communications Corp.*[10] was the first to consider whether the use of a competitor's trademark as a "keyword" to trigger banner advertisements was infringing. In that case, the defendant was the search-engine operator rather than the advertiser. The court reversed a grant of summary judgment for the search-engine operator and held that the plaintiff had raised an issue of fact concerning infringement so that a court could find infringement after a trial. The defendant search-engine operator displayed so-called "banner" ads across the top of its search-engine results. It required advertisers of adult-oriented entertainment to purchase a "keyword" list of over four hundred terms, including the plaintiff's trademarks "playboy" and "playmate." Accordingly, when a search-engine user entered either mark as a search term a banner ad for adult-oriented products or services other than those of Playboy would be displayed. The ads were sometimes confusingly labeled as to whether or not they were for Playboy's products and sometimes were not labeled at all. The ads also contained "click here" buttons that would take the user away from the search-results page to the Web site of one of the advertisers. Once there, it could become clear that it was not Playboy's Web site but the court found that the customer had already been diverted and was likely to get the adult-oriented products or services from the diverting site.

The court held that initial interest confusion was likely and so, following the rationale of *Brookfield*, the invisible keyword use of Playboy's trademark to divert business from Playboy was infringing. The court did not analyze whether the theory of liability against the search-engine operator was direct infringement or contributory infringement but held that it was at least one or the other and so Playboy's case could proceed.

The most important aspect of the *Playboy* case is the concurring opinion of Judge Marsha Berzon, who expressed concern that *Brookfield* may have been wrongly decided or was being too expansively applied and might "one day, if not now, need to be reconsidered *en banc.*" Judge Berzon's concurrence was the first judicial opinion to focus on the consumer benefit rationale for allowing invisible use of trademarks. She was able to agree with the majority because the banner ads in issue were confusing about who the advertiser was or did not specify who the advertiser was but merely invited the user to "click here." However, she expressed the following concern:

> As applied to this case, *Brookfield* might suggest that there could be a Lanham Act violation *even if* the banner advertisements were clearly labeled, either by the advertiser or by the search engine.… So read, the metatag holding in *Brookfield* would expand the reach of initial interest confusion from situations in which a party is initially confused to situations in which a party is never confused.[11]

Judge Berzon continued by noting that there is "a big difference" between "hijacking a customer to another website by making the customer think he or she is visiting the trademark holder's website" and "just distracting a potential customer with another *choice*, when it is clear that it is a choice."[12] As did the court in *Brookfield* she turned to a brick-and-mortar example to support her point:

> For example, consider the following scenario: I walk into Macy's and ask for the Calvin Klein section and am directed upstairs to the second floor. Once I get to the second floor, on my way to the Calvin Klein section, I notice a more prominently displayed line of Charter Club clothes, Macy's own brand, designed to appeal to the same people attracted by the style of Calvin Klein's latest line of clothes. Let's say I get diverted from my goal of reaching the Calvin Klein section, the Charter Club stuff looks good enough to me, and I purchase some Charter Club shirts instead. Has Charter Club or Macy's infringed Calvin Klein's trademark, simply by having another product more prominently displayed before one reaches the Klein line? Certainly not.[13]

Thus, the *Playboy* decision, specifically Judge Berzon's concurring opinion, represents an important judicial recognition that analysis of invisible trademark cases may

be headed down a slippery slope in a direction that gives too much recognition to the rights of trademark proprietors and not enough to consumer welfare. However, the Ninth Circuit has not yet reconsidered *Brookfield.*

Some judicial rethinking promptly followed Judge Berzon's expression of concern and may have led appellate courts to begin to consider the issue of whether invisible use of trademarks should be deemed trademark "use" at all. Lower courts that had considered whether invisible use of trademarks was "use" of trademarks in commerce for purposes of the Lanham Act reached differing results. Most of the cases involved software that generates pop-up ads, rather than search engine results, and were filed against WhenU.com, Inc., a leading pop-up ad company. Two early decisions, *U-Haul Int'l, Inc. v. WhenU.com, Inc.,*[14] and *Wells Fargo & Co. v. WhenU.com, Inc.,*[15] concluded, that invisible use was not "use," largely because the pop-up ad company did not use the trademarks to identify the source of its own goods or services and, indeed, did not display the trademarks at all.

In *U-Haul,* the court focused on the Lanham Act's definition of "used in commerce" to bolster its conclusion. Under that definition, a mark is "used in commerce" in connection with goods when the mark is "placed in any manner on the goods or their containers or the displays associated therewith or on the tags or labels affixed thereto…or on the documents associated with the goods or their sale."[16] A mark is "used in commerce" in connection with services when the mark is "used or displayed in the sale or advertising of services and the services are rendered in commerce."[17] As we will shortly see, this definition may have been ripped out of context and was never intended to apply to whether a trademark was "used in commerce" for purposes of infringing it.

The *Wells Fargo* court also relied on the Lanham Act's definition of "use in commerce" and reinforced its conclusion that invisible trademark use to trigger pop-up ads was not "use," by applying that definition to the Lanham Act's infringement section which forbids "use in commerce…of a registered mark in connection with the sale, offering for sale, distribution or advertising" of goods or services.[18] The former definition, however, was likely intended to apply to use for purposes of trademark registration, not for purposes of infringement.

Two trial court decisions rendered after those cases reached an opposite conclusion: *1-800 Contacts, Inc. v. WhenU.com, Inc.*[19]; and *Government Employees Insurance Co. v. Google, Inc.*[20] These courts used a more flexible definition of "used in commerce," reasoning that a trademark is "used" when it is used to trigger a pop-up ad or as a keyword to trigger a sponsored link.

The first decision to reach the appellate level was *1-800 Contacts, Inc.* In 2005, the Second Circuit[21] reversed the district court's decision. The court essentially agreed with the reasoning of *U-Haul* and *Wells Fargo* in applying the definition of "use in commerce" found in Section 45 of the Lanham Act to the phrase "use in commerce" found in the infringement sections of the Lanham Act (i.e., Sections 32 and 43(a)) and so held that there was no use of a trademark. The court also seemed to reject the proposition that "invisible" use of a trademark that is never seen by anyone but is just used by computer software could be "use in commerce" for any purpose. According to the court:

> A company's internal utilization of a trademark in a way that does not communicate it to the public is analogous to a[n] individual's private thoughts about a trademark. Such conduct simply does not violate the Lanham Act, which is concerned with the use of trademarks in connection with the sale of goods or services in a manner likely to lead to consumer confusion as to the source of such goods or services.[22]

Concerns similar to those expressed in Judge Berzon's concurring opinion in *Brookfield* clearly influenced the Second Circuit's decision in *1-800 Contacts, Inc.* After purporting to distinguish *Brookfield* and *Playboy,* by asserting that WhenU.com's conduct was different, the court states in a footnote that "[w]e note that in distinguishing *Brookfield* [and] *Playboy…*we do not necessarily endorse their holdings."[23]

District courts in other circuits largely declined to follow the Second Circuit's *1-800 Contacts, Inc.* decision.[24] The Eleventh Circuit[25] Court of Appeals also declined to follow the decision, noting that, "to the extent the *1-800 Contacts* court based its 'use' analysis on the fact that the defendant did not display the plaintiff's trademark, we think the Second Circuit's analysis is questionable."[26]

Thus, in March 2009, the district court in *Hearts on Fire*[27] stated that "[a]t present, the Second Circuit stands alone in holding that the purchase of a competitor's trademark to trigger internet advertising does not constitute a use for the purposes of the Lanham Act."[28] This split of case authority was troublesome. It meant that the same widely used Internet business practices would potentially constitute trademark infringement in most of the country but would be perfectly legal in the Second Circuit.

The Second Circuit addressed the problem the following month in *Rescuecom Corp. v. Google Inc.,*[29] decided on 3 April 2009. *Rescuecom* was a trademark infringement suit by a trademark owner against Google, a search-engine operator, for selling Rescuecom's trademark to a competitor as a keyword. The court below had dismissed the case for failure to state a claim, in the belief that *1-800 Contacts, Inc.,* mandated dismissal because there was no "use in commerce" of the plaintiff's trademark. Recognizing the importance of the case and apparently struggling with

how to craft an opinion straightening out the situation without expressly overruling *1-800 Contacts,* the Second Circuit took a full year to issue its decision. The court reversed the dismissal of the case, finding that trademark "use in commerce" had been adequately alleged, and marginalized *1-800 Contacts* almost to the point of limiting it to its facts.

To marginalize *1-800 Contacts,* the court reasoned that in that case the plaintiff had not alleged that the defendant used its trademark *at all* because the pop-up ad was triggered not by the trademark, but by the plaintiff's Internet domain name. The court made clear in a footnote that a Web site domain name *can* be a trademark. However, the *1-800 Contacts* decision was correct because "[t]he question whether the plaintiff's website address was an unregistered trademark was never properly before the *1-800* court because the plaintiff did not claim that it used its Web site address as a trademark."[30]

The *Rescuecom* court further bolstered its thinly veiled rejection of *1-800 Contacts* by reasoning that, in *Rescuecom,* Google's Keyword Selection Tool presented an actual visual display of the trademark to advertisers seeking to purchase it and Google displayed the mark to advertisers visually on other occasions. Thus, according to the court, "Google's utilization of Rescuecom's mark fits literally within the terms" of Section 45 of the Lanham Act. This reasoning enabled the court to avoid rendering any holding on the issue of whether the definition in Section 45 was intended to apply to the infringement sections of the Lanham Act.

However, the court followed its opinion with a lengthy appendix "on the meaning of 'use in commerce' in Sections 32 and 43 of the Lanham Act."[31] The appendix concludes that the definition in Section 45 was not intended to apply to Sections 32 and 43, the infringement provisions, so the *U-Haul* and *Wells Fargo* cases were wrongly decided. One may conclude that the appendix was originally intended to be part of the opinion, but was rendered unnecessary to the holding when the court decided to conclude that the Section 45 definition was, in fact, satisfied. The court decided to move the material to an appendix to illuminate what it viewed as the faulty reasoning of those two early cases.

The *Rescuecom* decision effectively brought the Second Circuit into harmony with the rest of the country on the issue of whether "invisible" trademark use could be use in commerce for purposes of the Lanham Act. However, the court was careful to note that, in vacating the district court's dismissal of the case on the pleadings, it was expressing no view on whether Rescuecom could prove a Lanham Act violation, and particularly whether anything Google did was likely to confuse consumers.

Thus, *Rescuecom* for all intents and purposes closed the book on the "use in commerce" issue and redirected the focus of "invisible" trademark use cases to consideration of whether the use of the competitor's trademark was likely to cause confusion.

C. The Current Focus on Likelihood of Confusion

As Judge Berzon had already realized in *Playboy,* the real policy issue in the debate over the "invisible" use of others' trademarks is whether consumers are confused and therefore harmed or not confused and therefore benefited by additional marketplace choices. Put simply, if material generated by keywords is adequately differentiated from "natural" search results on search-return pages to let the consumer know what it is—for example by terming such material "sponsored links" or placing it in a separate column—then confusion is doubtful. If, on the other hand, the consumer is unable to tell one from the other, then confusion is likely.

The focus on confusion as the key to whether the Lanham Act is violated has only just begun. The first reported decision to consider the issue, *Rosetta Stone Ltd. v. Google Inc.,*[32] found no confusion and granted summary judgment for Google. The case involved a direct challenge to Google's practice of selling Rosetta Stone's trademark to advertisers as a keyword. Rosetta Stone sells proprietary language-learning software. The advertisers either sold competing brands or counterfeit Rosetta Stone software. In finding that no reasonable trier of fact could find a likelihood of confusion, the court considered primarily three factors. First, it concluded that Google had no intent to confuse consumers. Second, it found that Rosetta Stone's evidence of supposed actual confusion was not sufficient to raise a material issue of fact. In particular, the court noted that all of Rosetta Stone's confusion witnesses testified that in purchasing counterfeit software they knew that they were not purchasing it directly from Rosetta Stone. Thus, they were not confused by the sponsored links but by the confusing nature of the Web sites from which they purchased. Finally, the court found that the sophisticated nature of the customer base, and the price of the product (approximately $250 to $500) indicated that consumer confusion was unlikely.

The *Rosseta Stone* decision did not really focus on what types of differentiation between sponsored and natural search results are best suited to avoid confusion. It thus gives little guidance to search-engine operators and other users of "invisible" trademarks. Hopefully future decisions will be more helpful.

VI. Conclusion

As detailed above, the process of working out how existing United States trademark laws should be applied to the new phenomenon of "invisible" trademark use on the Internet has been less than smooth and has taken several twists and turns. It seems, however, that courts have now begun to focus on what should really be the decisive issue: whether a particular "invisible" use is likely to confuse an appreciable number of consumers.

Endnotes

1. J. Thomas McCarthy, McCarthy on Trademarks & Unfair Competition § 25:70.1 (2004).
2. The United States Court of Appeals for the Ninth Circuit is one of twelve regional federal appellate courts established in the United States' federal court system. The Ninth Circuit covers California and a large portion of the western United States.
3. 174 F.3d 1036, 1064 (9th Cir. 1999).
4. 15 U.S.C. § 1051 *et seq*.
5. *Brookfield Communications v. West Coast Entertainment*, note 3 *supra*, at 1064.
6. 337 F.3d 1036 (9th Cir. 2003).
7. The Tenth Circuit covers the central western part of the United States.
8. 436 F.3d 1228 (10th Cir. 2006).
9. 411 F. Supp. 2d 901 (S.D. Ohio 2006).
10. 354 F.3d 1020 (9th Cir. 2004).
11. *Id.* at 1034 (emphasis in original).
12. *Id.* at 1035 (emphasis in original).
13. *Id.*
14. 279 F. Supp. 2d 723 (E.D. Va. 2003).
15. 293 F. Supp. 2d 734 (E.D. Mich. 2003).
16. *U-Haul*, note 14 *supra,* at 727; Lanham Act § 45, 15 U.S.C. § 1127.
17. *Id.*
18. Lanham Act § 32, 15 U.S.C. § 1114(1)(a).
19. 309 F. Supp. 2d 467 (S.D.N.Y. 2003), *rev'd*, 414 F.3d 400 (2d Cir.), *cert. denied,* 546 U.S. 1033 (2005).
20. 330 F. Supp. 2d 700 (E.D. Va. 2004).
21. The United States Court of Appeals for the Second Circuit covers the states of New York, Connecticut and Vermont.
22. *1-800 Contacts, Inc.*, n. 19 *supra*, 441 F.3d at 409.
23. *See Playboy*, note 10 *supra*, 354 F.3d at 1034-36 (Berzon, C.J., concurring, noting disagreement with holding in *Brookfield).*
24. Under the United States' federal court system, decisions of a Circuit Court of Appeals are binding precedent only within the circuit. Accordingly, only district courts in New York, Connecticut and Vermont were bound to follow *1-800 Contacts, Inc. E.g., Hearts on Fire Co., LLC v. Blue Nile, Inc.*, 603 F. Supp. 2d 274 (D. Mass. 2009); *Market America v. Optihealth Prods., Inc.*, 2008 WL 5069802 (M.D.N.C. 21 Nov. 2008); *Boston Duck Tours, LP v. Super Duck Tours, LLC,* 527 F. Supp. 2d 205 (D. Mass. 5 Dec. 2007); *Rhino Sports, Inc. v. Sport Court, Inc.*, 2007 WL 1302745 (D. Ariz. 2 May 2007); *Google Inc. v. Am. Blind & Wallpaper Factory, Inc.*, 2007 U.S. Dist LEXIS 32450 (N.D. Cal. 18 Apr. 2007); *Edina Realty, Inc. v. TheMLSonline.com*, 80 U.S.P.Q. 1039 (D. Minn. 2006); *800-JR Cigar, Inc. v. GoTo.com, Inc.*, 437 F. Supp. 2d 273 (D.N.J. 2006).
25. The Eleventh Circuit includes a number of Southeastern states.
26. *North Am. Med. Corp. v. Axion Worldwide, Inc.*, 522 F.3d 1211, 1219 (11th Cir. 2008).
27. *Hearts on Fire Co., LLC v. Blue Nile, Inc.*, 603 F. Supp. 2d 274 (D. Mass. 2009).
28. *Id.* at 281.
29. 562 F.3d 123 (2d Cir. 2009).
30. *Id.* at 128, n. 3.
31. *Id.* at 131.
32. 2010 WL 3063152 (E.D. Va. 3 Aug. 2010).

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The Consequences of the Dissolution of the Netherlands Antilles for the Practice of Corporate and Finance Law: A Puzzle with a Few Missing Pieces

By Bouke Boersma

I. Introduction

The Netherlands Antilles dissolved on 10 October 2010. The two largest islands that formed part of the Netherlands Antilles, Curaçao and St. Maarten, became independent countries within the Kingdom of the Netherlands. Apart from these two countries, the Kingdom consists of the Netherlands and, since 1 January 1986, Aruba. The four countries stand on equal footing: each country with its own set of laws but subject to the Statute of the Kingdom (*Statuut voor het Koninkrijk*) and certain Kingdom Acts (*Rijkswetten*). The Netherlands Antilles also included Bonaire, Sint-Eustatius and Saba, together known as the BES islands. The BES islands have, as public entities, chosen to become part of the Netherlands, a status comparable to that of a Dutch municipality.

Curaçao, St. Maarten and, insofar as it concerns the BES islands, the Netherlands are successors to the Netherlands Antilles. These countries have taken the place of the Netherlands Antilles with respect to applicable laws, legal obligations and legal relationships. It should be remembered that Curaçao, St. Maarten and the Netherlands can themselves decide, as autonomous countries, which legislation that was in force in the Netherlands Antilles before dissolution they want to amend or repeal. This article discusses the consequences of the constitutional reform in regard to the following topics: (i) the corporate and financial legislation of Curaçao, St. Maarten, and the BES islands; (ii) the applicability of treaties that were previously applicable to the Netherlands Antilles to Curaçao, St. Maarten, and the BES islands; and (iii) the validity of licenses, exemptions and other similar decisions issued or taken by Netherlands Antilles' authorities.

II. Corporate and Financial Legislation After 10 October 2010

A. Curaçao and St. Maarten

The corporate law of the former Netherlands Antilles was overhauled on 1 March 2004 and was incorporated in Book 2 of the Civil Code. The legislature of the Netherlands Antilles had intended to implement a set of ordinances to finalize the new civil law project before the dismantling of the Netherlands Antilles, but it is by now clear that the legislature of the Netherlands Antilles was unsuccessful in doing so. Curaçao and St. Maarten now want to implement these ordinances in 2011. The most important ordinances intend to amend Book 2 of the Civil Code, introduce the concept of trusts that is based on the Anglo-American trust,[1] amend the Code of Civil Procedure and the Bankruptcy Code of 1931 and, as the Netherlands intends to do, fully revise the outdated partnership legislation.[2] The most significant amendment is included in the proposal to amend Book 2 of the Civil Code and simplifies the conflict-of-interest rules. As under previously applicable law of the Netherlands Antilles, the proposed rule in principle only covers legal acts between the corporation and a managing director and legal proceedings between the corporation and a managing director. The corporation must in these limited circumstances be represented by the supervisory board if there is one, and, if not, by the other managing directors, acting jointly, and, if there are none, by a person who has been specially appointed by the general meeting of shareholders for that purpose.[3] All other possible conflicts of interest, for example, an employment contract entered into by the corporation with the son of a managing director, fall outside the scope of the proposed rule, unless the corporation's articles of association or by-laws provide otherwise. It should be noted that the conflicts of interest rule is optional and its applicability can be excluded partially or entirely.[4] A legal act executed in violation of Article 2:11 is void, unless the counterparty acted in good faith (which is in practice unlikely). The general meeting of shareholders will no longer have the authority to "always" appoint special representatives to represent the corporation in conflict-of-interest situations; moreover, the corresponding obligation of the managing directors to timely disclose conflicts of interest to the general meeting is done away with.

The financial supervision of the former Netherlands Antilles was sector-based, as was the case in the Netherlands before it implemented the Financial Supervision Act on 1 January 2007. The Central Bank of the Netherlands Antilles supervised financial institutions of the Netherlands Antilles pursuant to the Banking and Credit System Supervision Act 1994 (*Landsverordening toezicht bank- en kredietwezen 1994*), the Act on the Supervision of Investment Institutions and Administrators (*Landsverordening toezicht beleggingsinstellingen en administrateurs*), the Act on Foreign Exchange Transactions (*Landsverordening deviezenverkeer*), the Supervision of Stock Exchanges Act (*Landsverordening toezicht effectenbeurzen*), the Supervision of Trust Companies Act (*Landsverordening*

toezicht trustwezen) and the Act on the Supervision of Insurance Companies (*Landsverordening toezicht verzekeringsbedrijf*). The legislature of the Netherlands Antilles intended to harmonize various financial supervision laws before dissolution of the Netherlands Antilles, thereby eliminating inconsistencies that mostly resulted from the fact that none of the laws was enacted at the same time. The proposed legislation covered, inter alia, the following subjects: (i) silent receivership, (ii) fines, (iii) the publication of violations and, (iv) the appointment of an auditor in certain cases. The legislation cannot be described in further detail because it has not yet been published. In any event, it is by now clear that the Netherlands Antilles legislature did not enact this harmonization legislation before dissolution of the Netherlands Antilles.

The dissolution of the Netherlands Antilles itself did not materially change the corporate and financial laws applicable to Curaçao and St. Maarten. Ever since constitutional reform, a corporation with its seat on Curaçao or St. Maarten is governed by the law of Curaçao and St. Maarten, respectively (on the basis of the incorporation doctrine). The legislation that was in force in the Netherlands Antilles immediately before dissolution remains in effect in Curaçao and St. Maarten, including the corporate and financial legislation described above. Additional Article 1 of the Constitution of St. Maarten (*Staatsregeling van Sint Maarten*) provides that legislation of the Netherlands Antilles that was in force before dissolution continues to apply in St. Maarten until it is amended or revoked. The Act on the General Transitional Regime and Administration (*Landsverordening algemene overgangsregeling wetgeving en bestuur*), adopted by the Island Council of Curaçao before dissolution of the Netherlands Antilles pursuant to Additional Article 1 of the Constitution of Curaçao (*Staatsregeling van Curaçao*), confirms the continued applicability of Netherlands Antilles' legislation, provided that the laws that no longer apply in Curaçao are listed in an attachment. This list includes constitutive laws that have been replaced with laws fine-tuned for Curaçao and St. Maarten, such as their respective Constitutions, and joint regulations that will be entered into by Curaçao, St. Maarten and/or Aruba. Pursuant to Article 60b of the Statute of the Kingdom, which entered into force on 16 September 2010, draft ordinances that have been enacted by the Island Councils of Curaçao or St. Maarten before the constitutional reform, have the status of ordinances since 10 October 2010. The Act on the General Transitional Regime and Administration and the Act Protecting Personal Data (*Landsverordening bescherming persoonsgegevens*), which area of law was not regulated in the Netherlands Antilles, were enacted by the Island Council of Curaçao on this basis before the constitutional reform.

The corporate and financial legislation of Curaçao and St. Maarten differs substantially from the corresponding legislation of the Netherlands and Aruba, but is at the same time very similar. A reason for the similarity can be found in Article 39(1) of the Statute of the Kingdom that provides that all countries within the Kingdom of the Netherlands are to have substantially the same civil and corporate laws insofar as possible (the so-called concordance principle). Although heavily debated in Dutch and Dutch Caribbean juridical literature, this principle is not affected by the constitutional reform. Curaçao and St. Maarten have agreed that their civil, procedural and bankruptcy laws will remain the same going forward. The new Joint Court of Appeal (*Gemeenschappelijk Hof van Justitie*) of Aruba, Curaçao, St. Maarten and the BES islands could otherwise not have properly functioned as a joint appellate court. It is noted that the agreement to have identical civil, procedural and bankruptcy laws will be limited to Curaçao and St. Maarten and does not extend to the BES islands or Aruba. Curaçao and St. Maarten have also agreed that their financial supervisory legislation will remain the same, partly because the Central Bank of Curaçao and St. Maarten, which is the successor to the Central Bank of the Netherlands Antilles, has become the financial supervisor for both islands. It should be noted that when Aruba became independent about twenty-five years ago, Aruba and the Netherlands Antilles made a similar agreement (which probably came to an end on 10 October 2010) that was never followed upon.

B. BES Islands

The legal system of the BES islands is a hybrid and is complicated since the constitutional reform. Most of the laws of the Netherlands Antilles that were in force on 15 December 2009 have been converted into laws applicable in the BES islands (these are referred to as BES laws) without important changes. The Act on the Implementation of Public Entities BES (*Invoeringswet openbare lichamen BES*) contains a list of all laws of the Netherlands Antilles that remain in force in the BES islands. This list includes the Civil Code of the Netherlands Antilles and all financial laws of the Netherlands Antilles, with the exception, inter alia, of the Act on Foreign Exchange Transactions (*Landsverordening deviezenverkeer*). Legislation of the Netherlands Antilles that has thus been converted into Dutch legislation was immediately thereafter amended by way of the Amendment Acts Public Entities BES (*Aanpassingswetten Openbare Lichamen BES*). Although it is odd that laws of the Netherlands Antilles that were enacted or amended after 15 December 2009 did not immediately become applicable in the BES islands, this has mattered little in practice because the Amendment Acts purport to reflect amendments enacted by the legislature of the Netherlands Antilles after that date.

Since the constitutional reform, neither the law of the Netherlands in force before 10 October 2010 nor

European law is directly applicable to the BES islands. The Netherlands therefore effectively has two separate legal regimes. Perhaps surprisingly, the legal complications arising from having one country with two legal systems seem quite limited. This can be illustrated by considering three possible complications. It appears that a corporation with its corporate seat in the BES islands can relocate its corporate seat to the European part of the Netherlands and vice versa. The Kingdom Act on the Voluntary Relocation of Corporate Seats (*Rijkswet Vrijwillige Zetelverplaatsing Rechtspersonen*), which only permits corporations to relocate their corporate seat in cases of an emergency, such as war, does not seem to apply to corporations changing their corporate seat within the Netherlands. This could, perhaps unintentionally, open the door to Dutch corporations relocating their seat to countries outside the European Union or the European Economic Area, which otherwise would only be possible in cases of emergency. A Dutch corporation would first have to relocate its seat to one of the BES islands and could then easily relocate to any third country if the corporation continued to exist in the receiving country. A fiduciary security transfer (*fiduciare zekerheidsoverdracht*) that is enforceable under the laws of the BES islands will be recognized in the European part of the Netherlands, because it can be deemed to be equivalent to a Dutch security right, in this case a right of pledge. Financial institutions from the BES islands cannot become active in the European part of the Netherlands without an additional Dutch license. The same is true, mutatis mutandis, for Dutch financial institutions that want to become active in the BES islands. It can be expected, however, that Dutch financial institutions will easily be able to obtain an exemption from the applicable license requirement from the Dutch Central Bank (DCB) or the Netherlands Authority for the Financial Markets (AFM), as the case may be.

The bulk of the law of the Netherlands Antilles has remained substantially the same in the BES islands since 10 October 2010, with a few notable exceptions for the corporate law practice, including two exceptions described below. The Business Establishment Act BES (de *Wet vestiging bedrijven BES*) has been partially revised. The Act prohibits anyone from establishing or conducting its business in the BES islands without a license. The Business Establishment Act that was applicable in the Netherlands Antilles excluded from its scope persons born in the Netherlands Antilles and who are older than twenty-one years of age, but that exception has been deleted. The Business Establishment Act BES does not seem to include a transitional period so that any person born in the Netherlands Antilles and conducting a business without a license is violating that Act. The Stamp Duty Act 1908 (*Zegelverordening 1908*) and the Registration Act 1908 (*Registratieverordening 1908*) have not become applicable in the BES islands. A Netherlands Antilles judge was not able to render a judgment on the basis of evidentiary documents that did not have the appropriate stamp or were not registered with the Netherlands Antilles tax inspector. In normal circumstances all that was required was the payment of a nominal fee. The notable exception concerned mortgage deeds, which could result in significant taxes being levied (0.2% of the amount secured by the mortgage, excluding interest and costs). These taxes were payable at the time of execution of the mortgage deed before the civil-law notary.

The financial legislation of the Netherlands Antilles that is currently in force in the BES islands will initially not be changed, with a few exceptions, including the three exceptions discussed below. The Act on Foreign Exchange Transactions has not become applicable in the BES islands because the U.S. dollar will replace the Netherlands Antilles guilder as its official currency. It is worth noting that the Act on Foreign Exchange Transactions is, as of 10 October 2010, no longer in force, while the U.S. dollar will become the official currency on 1 January 2011. The Act prohibited all international payments from a Netherlands Antilles corporation or partnership as well as the granting of security relating to such international payments without a license from the Central Bank of the Netherlands Antilles, other than certain, not very common transactions that were allowed (the entering into short term banking facilities was by far the most commonly used exception). For the avoidance of doubt, the Act on Foreign Exchange Transactions remains in force on Curaçao and St. Maarten. Curaçao and St. Maarten will continue to use the Antillean guilder but will replace it in 2012 with a new currency, the Caribbean guilder. The Central Bank of the Netherlands Antilles has been replaced as financial supervisor by DCB and AFM. DCB supervises banks, insurance companies and trust companies, while the AFM supervises insurance brokers, investment institutions and investment administrators. Other financial institutions, such as securities issuing institutions, are not and will not be supervised in the short term, although they are subject to supervision in the European part of the Netherlands. As most financial institutions that are active in the BES islands are either an affiliate or a branch of financial institutions with their corporate seat in Curaçao or St. Maarten, the Central Bank of Curaçao and St. Maarten and the Dutch financial supervisors will work together more closely in the future.

It has, in principle, been agreed to replace the currently applicable BES laws with Dutch laws within approximately five years. The various financial-supervision laws are expected to be replaced by the Act Financial Markets BES (*Wet financiële markten BES*) and the Anti-Money Laundering and Financing of Terrorism Act BES (*Wet ter voorkoming van witwassen en financiering terrorisme BES*) on 1 January 2012. After this transitional period of relative legislative calm, the BES islands are expected to become

a part of the European Union by changing the currently held “countries and overseas territories” status of the BES islands to “outermost area” status. In the final stage, primarily Dutch and European legislation will be applicable in the BES islands, although exceptions will be made insofar as that is deemed appropriate in view of significant differences that could exist between the BES islands and the colder parts of the Netherlands.

III. Applicability of Treaties After 10 October 2010

A. Curaçao and St. Maarten

It is not entirely certain whether treaties that were applicable to the Netherlands Antilles continue to apply to Curaçao and St. Maarten without further action being taken on behalf of the new countries. The influential Dutch Advisory Council (*Raad van State*) believes that the Kingdom Administration (on behalf of Curaçao and St. Maarten) should inform the other parties to the treaties that were applicable to the Netherlands Antilles that such treaties continue to apply to Curaçao and St. Maarten. The Dutch Advisory Council bases its view on Article 17 of the Vienna Convention on Succession of States in respect of Treaties 1978 (*Verdrag van Wenen inzake statenopvolging met betrekking tot verdragen 1978*). The Dutch Minister of Foreign Affairs correctly disagrees with the Dutch Advisory Council, since the dissolution of the Netherlands Antilles did not constitute a succession of states but only a constitutional reshuffling of a part of the Kingdom. This can best be understood by remembering that the Netherlands, Aruba and the former Netherlands Antilles cannot enter into treaties themselves, only the Kingdom can. The applicability of treaties can obviously be limited to one or more parts of the Kingdom, which often happens in practice. The constitutional reform has done nothing to change this; it is still the Kingdom of the Netherlands and not one of the individual countries that enters into treaties. Consequently, Curaçao and St. Maarten are bound by and can derive rights from treaties that have been entered into by the Kingdom on behalf of the former Netherlands Antilles, including various tax treaties entered into by the Kingdom on behalf of the former Netherlands Antilles, without any further action being required therefore.

B. BES Islands

The constitutional changes do not affect the applicability of treaties to the BES islands. All treaties that were applicable to the Netherlands Antilles remain in force in the BES islands, even if they do not apply to the European part of the Netherlands, although the applicability of two treaties has been terminated (but they have no relevance for the corporate and finance law practice). Treaties applicable to the Netherlands, which were not applicable to the Netherlands Antilles, will for now remain only applicable to the European part of the Netherlands, with the exception of seventy-seven treaties that are not relevant to the practice of corporate and finance law. The Dutch legislature will further examine if other treaties should remain in force or become applicable to the BES islands. The Dutch legislature will decide in the future each time a treaty is entered into on behalf of the Netherlands, whether or not the treaty should also apply to the BES islands, taking account of the same circumstances that determine if Dutch legislation should become applicable in the BES islands.

IV. Validity of Licenses, Exemptions and Other Decisions After 10 October 2010

A. Curaçao and St. Maarten

Article 2 of the Act on the General Transitional Regime and Administration provides that non-legislative decisions taken by the Netherlands Antilles will remain in force in Curaçao. The explanatory notes to the Act on the General Transitional Regime and Administration make clear that these decisions include concessions, licenses and tax rulings. It is likely that the same holds true for St. Maarten, although St. Maarten has not yet adopted a law to that effect. The Act on the General Transitional Regime and Administration and the relevant BES laws that are described below can serve as a blueprint for St. Maarten. Pursuant to Article 44(2) of the Charter of the Central Bank of Curaçao and St. Maarten, licenses and exemptions granted by the Central Bank of the Netherlands Antilles remain valid on Curaçao and St. Maarten. Judgments issued by the Joint Court of Justice and the Courts of First Instance of the Netherlands Antilles and Aruba before the constitutional reform will remain in force. Legal proceedings that were pending before the Joint Court of Justice or a Court of First Instance are by operation of law deemed to be pending before the new Joint Court of Justice or the applicable new Court of First Instance, as the case may be.

B. BES Islands

Decisions taken by the Netherlands Antilles prior to the regime change are generally deemed equivalent to decisions taken by the Netherlands. Consequently, licenses, exemptions and other decisions issued or taken by the Netherlands Antilles remain in effect in the BES islands. Foreign credit institutions and insurance companies with a branch in the BES islands are exempt from most financial supervision rules, as long as they comply with certain conditions. DCB will supervise the compliance of these branches with anti-money laundering and anti-terrorism rules. It should be noted that financial institutions that have obtained a license from the Central Bank of the Netherlands Antilles but which were not active in the BES islands immediately before 10 October 2010 will not receive a license by operation of law to operate in the BES islands. If such a license holder wants to become active in the BES islands in the future, it must first obtain a license from DCB or the AFM.

V. Conclusion

The legislature of the Netherlands Antilles had intended to implement a set of ordinances before dissolution of the Netherlands Antilles, but it is by now clear that it was unsuccessful in doing so. The legislation that was in force in the Netherlands Antilles immediately before dissolution has substantially remained in force in Curaçao, St. Maarten and the BES islands; this includes corporate and financial legislation. The dissolution of the Antilles itself did not materially change the corporate and financial laws in force in Curaçao and St. Maarten. The most important exceptions for the BES islands are that the Act on the Foreign Exchange Transactions (*Landsverordening deviezenverkeer*), the Stamp Duty Act 1908 (*Zegelverordening 1908*) and the Registration Act 1908 (*Registratieverordening 1908*) have not become applicable in the BES islands. Licenses, exemptions and similar decisions issued or taken by the Netherlands Antilles prior to the constitutional reform are generally deemed equivalent to decisions issued or taken by the Netherlands insofar as it concerns the BES islands. The same applies, mutatis mutandis, to Curaçao and St. Maarten, with the proviso that St. Maarten has not yet published a law to that effect. It depends on the circumstances whether a contract expressed to be governed by the law of the Netherlands Antilles should now be understood to refer to the laws of Curaçao, St. Maarten or the BES islands. In deciding this matter, a Dutch Caribbean court can be expected to take into consideration all relevant circumstances, including a possible choice of forum for a specific island in the contract, the location of the parties or the location of assets involved in the contract. Thus, a contract governed by the law of the Netherlands Antilles that is made between corporations located in the United States and Curaçao, respectively, would most likely now be deemed to be governed by Curaçao law. The same analysis also applies to forum choices of courts of the Netherlands Antilles. It will therefore in most cases not be necessary to amend a contract with respect to these matters.

Endnotes

1. Article 3:127 et seq. of the Civil Code.
2. Title 13 of Book 7 of the Civil Code.
3. Article 2:11(1) of the Civil Code.
4. Article 2:11(2) of the Civil Code.

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Arbitration in Germany

By Philipp K. Wagner

I. Introduction

While arbitration has had a long history in Germany, it significantly matured with Germany's adoption of the UNCITRAL Model Law on International Commercial Arbitration in 1998. This new arbitration law (hereinafter referred to as the "German Arbitration Law") is included in the tenth book (Section 1025 *et seq.*) of the German Code of Civil Procedure, or, in German, *Zivilprozessordnung* ("ZPO").[1] A complete translation of the German Arbitration Law in English is available at www.dis-arb.de, which is the website of the major arbitration institution in Germany, the German Institution of Arbitration, or *Deutsche Institution für Schiedsgerichtsbarkeit e.V.* ("DIS").

Even before adoption of the UNCITRAL Model Law as its arbitration law, Germany had already previously ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (hereinafter referred to as the "New York Convention)."

This article will provide an overview of the major aspects of arbitration in Germany, including discussions on (i) its legal framework, (ii) the available infrastructure, (iii) the arbitration agreement, (iv) the constitution of the arbitral tribunal, (v) the conduct of the arbitral proceedings, (vi) the arbitral award and its recognition and enforcement, and (vii) annulment proceedings. For a more in depth reading on arbitration in Germany, the publishing house of Walters Kluwer recently published a very detailed commentary in English.[2]

II. Major Aspects of Arbitration in Germany

A. Legal Framework

Notwithstanding any international treaties or institutional or other arbitration rules chosen by the parties, the German Arbitration Law is the underlying basis of domestic and foreign arbitration, applicable whenever the place of arbitration is situated in Germany. The main concept is that parties to an arbitration agreement are free to agree on the conduct of the arbitral proceedings, either by agreeing on specific procedural rules or by making reference to a set of arbitration rules, subject to certain mandatory provisions, including due process rights and several provisions relating to access to German courts.[3]

In addition to the New York Convention referred to above, international treaties in the field of arbitration to which Germany is a party include (i) the European Convention on International Commercial Arbitration and (ii) the Washington Convention on the Settlement of Investment Disputes between States and Nationals of other States ("ICSID Convention").

B. Arbitration Infrastructure

The DIS is certainly the most important arbitration institution in Germany. It has established arbitration rules (the "DIS Rules"), which are, among other languages, available in English and can be downloaded from the DIS website.[4] In addition, the DIS provides for supplementary rules for corporate law disputes and expedited proceedings, as well as rules regarding other dispute resolution mechanisms, such as mediation or adjudication.[5] With respect to arbitration, the DIS administers an increasing number of domestic and international arbitration proceedings under its own rules (one hundred new cases in 2007, 122 new cases in 2008, and 171 new cases in 2009).[6] It also serves as the competent authority for the duties of the ICC in Germany, regularly acts as appointing authority for *ad hoc* proceedings, and provides general advice on the selection of arbitrators.[7] Parties having a legal presence in the United States have been involved in DIS arbitration (either as claimant or respondent or both) for at least the past seven years.

Other institutions that may assist in the context of arbitration in Germany include the respective regional Chambers of Commerce and Industry, in German, *Industrie- und Handelskammer* ("IHK"), which are based in larger German cities.[8]

Regarding *ad hoc* proceedings, it is not surprising that arbitration proceedings will, in most cases, be governed by the agreement of the parties as well as the German Arbitration Law. Often, the parties will provide for an independent institution, such as a local IHK or other professional or business association, to appoint one or more arbitrators if the parties fail to agree in such respect.

C. The Arbitration Agreement

An arbitration agreement between the parties can exclude the jurisdiction of the German courts. If a party brings an action in court with respect to a matter which is exclusively subject to resolution pursuant to an arbitration agreement, the court must reject the action for lack of jurisdiction, provided the defendant objects to the court's jurisdiction prior to the beginning of the oral hearings on the substance of the dispute, unless the court finds that the arbitration agreement is null and void, inoperative or incapable of being performed.[9]

As far as the necessary content of an arbitration agreement is concerned, it is sufficient that it is clear from the wording of the agreement that the parties intend to submit disputes to arbitration and wish to deviate from the jurisdiction of German courts.[10] The German Arbitration Law provides that an arbitration agreement

is an agreement by the parties to submit to arbitration all or certain legal disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.[11] Since the German Federal Court of Justice (hereinafter "FCJ") has ruled that an arbitration agreement is a substantive contract regarding procedural rights admissibility and necessary formal requirements are governed by procedural law, whereas all other questions regarding its execution are governed by substantive contract law.[12]

Furthermore, an arbitration agreement is to be treated separately from the main contract. Thus the ZPO explicitly provides that an arbitration clause which forms part of a contract is to be treated as an agreement independent of the other terms of the contract and, as a consequence, any defects which may render the main contract invalid do not, in themselves, affect the arbitration agreement and vice versa.[13]

Regarding arbitrability, German Arbitration Law provides for a two-step test: Arbitrability exists either (i) when a claim involves a so-called economic interest, such as money or specific performance; or (ii) for any other claim, to the extent that the parties are entitled to conclude a settlement on the issue in dispute.[14] There exist only a limited number of exceptions to this two-step test, which include criminal law, certain aspects of insolvency, disputes over residential leases, certain labor law disputes, as well as marital and child custody disputes.[15] Regarding the arbitrability of intra-company disputes, it was long disputed if (and to what extent) applications to set aside resolutions adopted in a general meeting of shareholders were arbitrable. In April 2009, the FCJ deviated from its former case law in holding that such disputes are arbitrable, provided that the arbitral proceeding is conducted in a manner which is comparable to proceedings in German courts; that is to say, observing minimum standards concerning participation rights of all shareholders bound by the arbitration agreement.[16]

The formal requirements for an arbitration agreement include that it must be contained either in a document signed by the parties or an exchange of letters, telefaxes, telegrams or other means of telecommunication that provide a record of the agreement.[17] That requirement is met by arbitration clauses contained in general terms and conditions that one party refers to, as well as a letter of confirmation sent by one party.[18] Non-compliance with such formal requirements may be impliedly waived by entering an argument on the substance of the dispute in the arbitral proceedings.

Even though the German Arbitration Law does not contain any specific provision on such an issue, it is undisputed that the arbitration agreement remains in force and binding on the insolvency administrator in the event of the insolvency of a party to an arbitration agreement. It has been discussed, however, whether an arbitration agreement may, under certain circumstances, become unenforceable due to the insolvency of a party, based on a decision by the FCJ.[19] In its decision in that matter, the Court held that, absent such a ruling, if an impecunious party no longer paid its share of the advance on costs where the other party refused to pay the entire advance on costs, the arbitration agreement would become unenforceable, giving the impecunious party access to German courts.

D. The Arbitral Tribunal

The parties to an arbitration agreement are free to determine the number of arbitrators. Absent such a determination, the number of arbitrators will be three.[20] While the parties are free to agree on a procedure of appointment of the arbitrator (or arbitrators), the general rule is that, regarding an arbitral tribunal consisting of three arbitrators, each party appoints one arbitrator and those two party-appointed arbitrators shall appoint the chairperson of the arbitral tribunal.[21] If the parties fail to appoint their respective arbitrators or if the two arbitrators fail to agree on the third arbitrator, the appointment will be made, upon the request of a party, by the competent Higher Regional Court *(Oberlandesgericht)* (i) that the parties have selected or (ii) for the district in which the place of arbitration is located.[22]

Since the German Arbitration Law does not contain any provisions regarding multi-party arbitration, such an issue should be considered when drafting an arbitration agreement. However, German courts have held that, absent any specific multi-party arbitration agreement, the underlying rationale of the provisions on the appointment of arbitrators in multi-party arbitrations contained in the ICC rules of arbitration and the DIS Rules are to be applied accordingly. This means that, in the absence of a joint nomination or where all parties are unable to agree on a method for the constitution of the arbitral tribunal, German courts will at least appoint the two arbitrators who would normally have been appointed by the parties.[23]

Although the German Arbitration Law does not require specific professional qualifications for arbitrators, an arbitrator can be challenged if circumstances exist and give rise to justifiable doubts as to such arbitrator's impartiality or independence.[24] Such a challenge can be made either (i) according to the challenge procedure agreed to by the parties or (ii) absent such agreement, by notification to and decision of the arbitral tribunal. If a challenge under any of the aforementioned procedures is not successful, the challenging party may request the court to decide on the challenge.[25]

E. Conduct of Arbitral Proceedings

Unless otherwise agreed by the parties, the arbitral proceedings commence on the date on which the request for the particular dispute is received by the respondent.[26]

The request must contain the names of the parties, the subject matter of the dispute, and a reference to the arbitration agreement. Under the DIS Rules, proceedings commence upon receipt by the DIS secretariat of the statement of claim, which must contain (i) an identification of the parties, (ii) a specification of the relief sought, (iii) particulars regarding the facts, (iv) the circumstances which give rise to the claim or claims, (v) a reproduction of the arbitration agreement, and (vi) a nomination of an arbitrator, unless the parties have agreed on a decision by a sole arbitrator.[27] As soon as the DIS has received sufficient copies of a statement of claim, as well as the administrative fee and the provisional advance on the arbitrators' costs (in accordance with the schedule of costs that applies under the DIS Rules), it will deliver the statement of claim to the respondent.[28]

Upon constitution of the arbitral tribunal, the arbitral proceedings are to be conducted according to the applicable rules and any further agreement of the parties. In the absence of such rules and/or agreement, the arbitral tribunal has large discretion on how to conduct the proceedings.[29] Neither the German Arbitration Law nor the DIS Rules provide for terms of reference or similar procedural instruments. During the entire term of the arbitration proceedings, each party is to be treated with equality and is to be given full opportunity to present its case.[30] Although it is not obligatory that a party be represented by counsel, counsel may not be excluded from acting as authorized representatives.[31]

With respect to the place of the arbitration, the parties are free to agree on a place they collectively deem appropriate. If the parties wish to arbitrate within Germany, they must take into account that, failing any further party agreement, the competent court for annulment and/or enforcement of the award as well any supportive measures regarding the conduct of the arbitration proceedings will be the Higher Regional Court in the district in which the place of arbitration is located. Even though an increasingly harmonized case law on most issues regarding arbitration has developed since the time the German Arbitration Law came into force,[32] some courts tend to be more experienced with arbitration than others.

Failing any party agreement regarding the place of arbitration, it will be determined by the arbitral tribunal.[33] Oral hearings are not mandatory under the German Arbitration Law. The parties are free to agree whether they want the proceedings to include an oral hearing or not, failing which the arbitral tribunal will decide accordingly.[34]

Even though arbitration proceedings are generally regarded as being confidential, the German Arbitration Law does not contain any confidentiality provision, whereas the DIS Rules explicitly provide that the parties, the arbitrators and persons at the DIS secretariat involved in the arbitration are to maintain strict confidentiality toward any third person regarding the conduct of the arbitral proceedings and, in particular, regarding the parties and any means of evidence.[35]

With respect to evidence, the arbitral tribunal (i) is empowered to determine its admissibility and (ii) may take and assess freely any evidence submitted, unless the parties have agreed otherwise and provided that the German Arbitration Law does not contain any specific evidence provisions.[36] Except for expert witnesses, the German Arbitration Law does not make reference to any specific means of evidence.[37]

However, witnesses (including written witness statements), experts, documents and inspection by the arbitral tribunal are admissible. Upon the request of either the arbitral tribunal or a party with the approval of the tribunal, the competent court may provide assistance in taking evidence or performance of other judicial acts that the arbitral tribunal is not empowered to carry out, which include, for example, subpoenaing witnesses.[38]

It is important for the American reader to understand that discovery is practically unknown to German law and creates major conflicts with (EU) data protection requirements.[39] However, there is a tendency in the German arbitral community to seek guidance from the IBA Rules on the Taking of Evidence, and those Rules provide for a certain degree of document production. Also, arbitral tribunals and parties may make use of the U.S.'s comparatively liberal approach to discovery and may seek permission from U.S. courts to conduct discovery under 28 U.S.C. Section 1782.[40]

Interim measures are available to the parties and can be granted either (i) by the competent court at the request of a party, regardless of the provisions contained in the arbitration agreement,[41] or (ii) by the arbitral tribunal itself,[42] including security for costs in connection with such measures. However, any interim measure granted by the arbitral tribunal is not enforceable as such. The court may, at the request of a party, repeal or amend such interim measure or permit its enforcement, unless application for a corresponding interim measure has already been made to the court.[43]

Finally, arbitral proceedings are either terminated by a final award or by an order of the arbitral tribunal, in each case leading to the termination of its mandate.[44]

F. The Arbitral Award

The arbitral tribunal may rule on its own jurisdiction and, in this connection, on the existence or validity of the arbitration agreement, known as "Competence-Competence."[45] If the arbitral tribunal finds that it has jurisdiction, which it may have by means of a preliminary ruling, any party may request, within one month after having received written notice of that ruling, that the relevant court decide the matter. While such a request is

pending, the arbitral tribunal may continue the arbitral proceedings and make an award.[46]

The arbitral award is to be made according to the substantive law (i) that has been chosen by the parties or (ii) absent any such designation, with which the subject matter of the proceedings is most closely connected, taking into account the terms of the underlying contract and the usages of the trade applicable to the transaction.[47] The arbitral tribunal is to make its decision by a majority of all its members, unless otherwise agreed by the parties. If the parties settle a dispute during the arbitral proceedings, the arbitral tribunal is to terminate the proceedings and, upon request by the parties, issue an arbitral award on agreed terms, provided that its content is in line with public policy.[48]

The arbitral award that is to be made in writing and signed by the members of the arbitral tribunal must contain the reasoning for the award, unless the parties have agreed otherwise.[49] The arbitral award has the same effect between the parties as a final and binding court judgment, also known as *res judicata*.[50]

With respect to the costs of the arbitral proceeding, the German Arbitration Law provides that, absent any agreement by the parties, the arbitral tribunal is to allocate, by means of the arbitral award, the costs between the parties, including any expenses or lawyer fees in connection with the dispute. There is certainly a likelihood that German arbitral tribunals will make their decisions according to the principle of cost allocation applicable in German civil procedure, pursuant to which the losing party bears the entire costs of the proceeding (including the winning party's lawyer's fees), as opposed to the typical American rule. However, since the arbitral tribunal also takes into consideration the circumstances of the case when making its cost decision,[51] a case-by-case solution may be appropriate. Unlike ICC arbitration, there is no scrutiny of the award by any particular authority prior to its rendering, whether the proceedings are *ad hoc* or conducted under the DIS Rules. However, the parties may request that the arbitral tribunal (i) correct errors in the award, whether they be in computation or typographical; (ii) give an interpretation of specific parts of the award; or (iii) make an additional award as to claims presented in the arbitral proceedings but omitted from the award.[52]

G. Annulment Proceedings

An award may be challenged before the Higher Regional Court in the district in which the place of arbitration is located or which the parties have designated.[53] Grounds for setting aside an award include (i) lack of capacity of a party, (ii) invalidity of the arbitration agreement, (iii) violation of due process principles, (iv) *ultra vires* decisions, and (v) improper constitution of the arbitral tribunal. These grounds must be shown and proved by the applicant.[54] The courts may further find, *sua sponte*, that an award should be set aside for lack of arbitrability or where the award leads to a result which violates German principles of public policy.[55] Unless the parties have agreed otherwise, an application for setting an award aside may not been made later than three months after the receipt of the award by the applicant.[56]

H. Recognition and Enforcement

With respect to recognition and enforcement of an arbitral award, a distinction should be made between the enforcement of foreign and of domestic awards.

As far as domestic awards are concerned, the competent court for enforcement will be the Higher Regional Court competent for annulment proceedings as set out above. An application for declaration of enforceability will be refused (and the award set aside) if one of the grounds for annulment under ZPO Section 1059 is applicable.[57]

The recognition and enforcement of foreign arbitral awards will be granted according to the New York Convention.[58] If the award is set aside abroad, after having been declared enforceable in Germany, an application for setting aside the declaration of enforceability may be made before the competent German court,[59] which would be the Higher Regional Court in the district of which the party opposing the application has its place of business or place of habitual residence, or where assets of that party or the property in dispute affected by the measure is located, absent which the Berlin Higher Regional Court *(Kammergericht)* has jurisdiction.[60] As can be noted from available case law, the only defense which proves to have a reasonable chance to succeed in practice is that of the lack of a valid arbitration agreement.[61]

Regarding the issue of double exequatur of arbitral awards, *i.e.*, the enforcement of foreign court decisions incorporating arbitral awards and declaring them enforceable, the FCJ, deviating from its previous case law, has held that such double exequatur are not permissible in Germany, since it would circumvent the rules applicable to the recognition and enforcement of foreign arbitral awards.[62]

III. Conclusion

The German Arbitration Law provides for a structured basis for arbitration in Germany side by side with the DIS Rules. Moreover, since Germany has adopted the New York Convention, the recognition of foreign arbitral awards is facilitated. German courts, which are developing an increasingly harmonized case law under the guidance of the German Federal Court of Justice, contribute to the fact that Germany as place of arbitration may be an acceptable or even desirable alternative to other places.

Endnotes

1. ZPO §1033.
2. Böckstiegel, Kröll, Nacimiento, eds. ARBITRATION IN GERMANY: THE MODEL LAW IN PRACTICE 28 (2007).
3. *Id*. at 37.
4. www.dis-arb.de.
5. All of these rules are also available for download at the DIS website.
6. SchiedsVZ 2010, p. III; SchiedsVZ 2009, p. VII; SchiedsVZ 2008, p. VII.
7. Böckstiegel *et al.*, note 2 *supra*, at 28.
8. IHK Berlin (www.berlin.ihk24.de), IHK Hamburg (www.hk24.de), and IHK Munich (www.muenchen.ihk.de), just to name the Chambers of Commerce and Industry of the three largest German cities.
9. ZPO §1032.
10. Böckstiegel *et al.*, note 2 *supra*, at 24.
11. ZPO §1029, subsec. 1.
12. Böckstiegel *et al.*, note 2 *supra*, at 47.
13. ZPO §1040, subsec. 1.
14. *Id*. §1030, subsec. 1.
15. *Cf*. Böckstiegel *et al.*, note 2 *supra*, at 18.
16. German Federal Court of Justice (BGH), 6 April 2009, SchiedsVZ 2009, 233. The DIS provides for case summaries in English of all court decisions it publishes in the "SchiedsVZ" or in its online database at www. dis-arb.de.
17. ZPO §1031.
18. Böckstiegel *et al.*, note 2 *supra*, at 131 *et seq*.
19. BGH, 15 September 2000, (2002) Int.A.L.R. N-11. *Cf*. Böckstiegel *et al.*, note 2 *supra*, at 144.
20. ZPO §1034, subsec. 1.
21. ZPO §1035, subsec. 3.
22. ZPO §§1035, subsec. 3 and 1062, subsec. 1(1).
23. Higher Regional Court (KG) of Berlin, 21 April 2008 – case No. 20 SchH 04/07 (available for download from the DIS database at www.dis-arb.de).
24. ZPO §1035.
25. ZPO §1037.
26. ZPO §1044.
27. DIS Rules §6.
28. DIS Rules §4, 7 and 8.
29. ZPO §1042, subsecs. 3 and 4.
30. ZPO §1042, subsec. 1.
31. ZPO §1042, subsec. 2.
32. Kröll, *Die schiedsrechtliche Rechtsprechung des Jahres 2008*, SchiedsVZ 2009, 161.
33. ZPO §1043.
34. ZPO §1047, subsec. 1.
35. DIS Rules §43, subsec. 1.
36. ZPO §1042, subsec. 4.
37. ZPO §1049.
38. ZPO §1050.
39. Retzer and Kahn, *Balancing Discovery with EU Data Protection in International Arbitration Proceedings*, 3 NYSBA NEW YORK DISPUTE RESOLUTION LAWYER 47 *et seq.* (Spring 2010).
40. Zaslowsky, *Use of Section 1782 in Aid of International Arbitration: The View from the Fifth Circuit*, 3 NYSBA NEW YORK DISPUTE RESOLUTION LAWYER 58 *et seq.* (Spring 2010).
41. ZPO §1033.
42. ZPO §1041.
43. ZPO §1041, subsecs. 2 and 3.
44. ZPO §1056.
45. ZPO §1040.
46. ZPO §1040, subsec. 3.
47. ZPO §1051.
48. ZPO §1053.
49. ZPO §1054.
50. ZPO §1055.
51. ZPO §1057.
52. ZPO §1058.
53. ZPO §1062.
54. ZPO §1059, subsec. 2(1).
55. ZPO §1059, subsec. 2(2).
56. ZPO §1059, subsec. 3.
57. ZPO §1060.
58. ZPO §1061, subsec. 1.
59. ZPO §1061, subsec. 3.
60. ZPO §1062, subsec. 2.
61. Kröll, *Die schiedsrechtliche Rechtsprechung des Jahres 2009*, SchiedsVZ 2010, 144.
62. BGH, 2 July 2009, SchiedsVZ 2009, 285; Kröll, note 61 *supra*, at 144.

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Offshore Arbitration—The Best Option for Non-Chinese Clients in China?

By Zhang Shouzhi, Xu Xiaodan and Hu Ke

I. Introduction

In most Sino-foreign joint venture contracts or in international trade contracts and financing agreements between a Chinese entity and a foreign party, the foreign party usually nominates an offshore arbitration forum such as the Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC), the International Court of Arbitration of the International Chamber of Commerce (ICC), or the Arbitration Institute of the Stockholm Chamber of Commerce (SCC), as the preferred means of settling potential disputes. One of the important reasons for foreign parties to do so is that they are concerned that they might not be able to utilize China's judicial and arbitration system efficiently. Their lack of understanding of or their lack of exposure to Chinese courts and arbitration institutions may be a cause of this concern. As a result, Chinese courts and arbitration institutions are not favored, but the question remains: does offshore arbitration actually provide better protection of the interests of overseas parties?

This article discusses the problems that offshore arbitration may cause for foreign parties. It is based on our experience in handling offshore arbitrations and in dealing with the recognition and enforcement of offshore arbitral awards.

II. Interim Injunctions Rendered by Offshore Arbitrational Tribunals Are Not Enforceable in China

Currently, domestic laws and arbitration rules of most jurisdictions allow arbitration tribunals to issue interim injunctions to preserve the disputed property or related evidences. However, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the "New York Convention")[1] applies to the recognition and enforcement of arbitral awards rendered by arbitration tribunals in contracting states and not containing procedural orders. As a result, unless specifically provided in any other relevant treaties that bind both China and the country where the arbitration is conducted, an injunction issued by an arbitration tribunal in another contracting state cannot be enforced in China.

To date, the People's Republic of China (PRC) has not entered into any bilateral or multilateral treaties[2] that recognize and enforce injunctions made in offshore arbitration proceedings. In addition, the PRC Civil Procedure Law ("Civil Procedure Law") and the PRC Arbitration Law ("Arbitration Law") do not allow the parties or the tribunal in an offshore arbitration to apply for interim injunctions in Chinese courts. Therefore, property or evidence preservation orders issued by an offshore arbitration tribunal will not be recognized and enforced in China.

For these reasons, a party in an offshore arbitration might be able to conceal or destroy adverse evidence and/or conceal or transfer the party's property in China. In many offshore arbitrations, especially at the later stages of the arbitration proceedings, one party may believe that it is in an unfavorable position and at risk of losing the case based on its perception of the tribunal's attitude, its evaluation of the evidences produced by the other party, and what transpired during the arbitration proceedings. In such circumstances, this party would possibly create a pledge or mortgage encumbering its main assets in China or transfer those assets to related companies. In some cases, parties have even gone as far as restructuring or liquidating the companies involved in the arbitration.

Once such a transfer of assets is completed, the other party, though armed with a prevailing arbitral award, will find it difficult to obtain payment from these assets through recognition and enforcement. In a number of cases, although the losing party was ordered by an offshore arbitral tribunal to pay the winning party tens of millions of US dollars in compensation, the winning party was still unable to have a single cent paid because the losing party had already disposed all of its assets during the arbitration proceeding and thus had become an empty shell.

III. Offshore Arbitration Is Time-consuming

Although many articles comparing litigation and arbitration comment that an offshore arbitration is usually faster and more efficient because of its finality, facts on the ground indicate that this perception of its efficiency is often misguided. A dispute arising from a regular joint venture ("JV") contract usually takes two years or longer to reach an award in an offshore arbitration. That would undoubtedly jeopardize the JV company's growth prospects and materially disrupt its normal business operation.

An offshore arbitration could take a much longer time mainly due to procedural disputes. In an offshore arbitration, the procedural laws of the country where the arbitration takes place will be applied. Most of these procedural laws are or have been profoundly influenced by common law tradition, which tends to attach great importance to procedural issues. As a result, disputes between the parties regarding the applicable arbitration procedures are likely to be much more drastic in an offshore arbitration.

What is more, the waiver rule, such as provided in Article 33 of the ICC Rules of Arbitration,[3] impels the parties to raise their objections about procedural issues early in the process to avoid being treated as having made a waiver of rights. Hence, parties are frequently involved in disputes concerning procedural issues and probably have to exchange their opinions several times, which will consequentially delay the proceedings. Furthermore, in cases where PRC law governs the disputed contract, the duration of the proceedings will invariably be prolonged because the tribunal will need to seek assistance from experts on PRC law, and the parties will have to retain these experts, prepare expert witness statements and cross-examine the other party's expert witnesses. The engagement of these experts would be unnecessary if the arbitration were conducted in China.

In addition, the parties not only have to spend a fair amount of time on procedure, but also have to wait for a long period of time before an award can be recognized and enforced by a court in China. According to the New York Convention and relevant judicial interpretations in China, the award and the contract including the arbitration clause and other materials should be notarized, authenticated and translated into Chinese if the winning party intends to initiate the procedure of recognition and enforcement of a foreign award in China. All of this preliminary work probably takes two months or so to complete.

IV. Offshore Arbitration Faces Judicial Challenge in China

It should be noted that the relevant Chinese judicial interpretations require an intermediate court to render its ruling within two months after receipt of a Foreign Enforcement Application if the court decides to recognize and enforce a foreign award.[4] But if the court finds that the award falls into one of the conditions provided in Article 5 of the New York Convention and believes the application should be rejected, the court is then to report its finding to a competent high court for a determination. Should the high court agree with the finding of the intermediate court, it must then report the same to the Supreme People's Court.[5] The purpose of this reporting system is to centralize the power of refusing recognition and enforcement of foreign awards in the Supreme People's Court, thereby reducing the risk of local protectionism in lower level courts and ensuring that China's judiciary properly performs its duties under the New York Convention.

However, in practice, the reporting system that aims at supporting foreign arbitration awards is frequently abused by losing parties to delay the recognition and enforcement of an award. Specifically, the losing party will try its best to find and even overstate the defects in aspects of the arbitral procedure, so as to dissuade the intermediate court and the high court from honoring the award. It could take one year or longer before the Supreme People's Court renders a final ruling as to whether to deny recognition and enforcement. During the waiting period, the losing party might have transferred its assets to avoid repayments.

V. Offshore Arbitration Is Costly

An offshore arbitration is not only time-consuming but also costly because of the following:

(1) Parties to foreign arbitration may be charged arbitrators' fees in addition to administrative fees, with arbitrators' fees usually calculated at the rate of a few hundred US dollars per hour;

(2) Travel expenses incurred by the parties and the witnesses while attending hearings abroad and the fees paid to lawyers are usually higher than in onshore arbitrations; and

(3) An offshore arbitration tribunal usually requires PRC lawyers and foreign lawyers to coordinate with each other, which will result in additional attorney fees, especially when the arbitration takes place in Hong Kong or the UK, where experienced and also expensive barristers are usually necessary. Furthermore, since arbitration proceedings can become a fairly time-consuming process, attorney fees charged on an hourly basis will usually be much higher than they would be in an onshore arbitration.

VI. Foreign Arbitral Institutions May Misapply PRC Laws

In offshore arbitrations, arbitrators without a Chinese legal background sometimes misapply PRC laws. Most foreign arbitrators have to rely on legal expert witness statements, which may have been unduly influenced by the engaging parties. In some extraordinary cases, legal experts retained by the parties have totally opposite opinions on the same issue, causing more confusion, instead of being helpful to the arbitrators.

Moreover, foreign arbitrators may find it difficult to accept some provisions of PRC law. For example, it is hard for them to understand why PRC law requires a JV contract or an equity transfer contract of a JV company to be first approved by the Ministry of Commerce before the contract can come into force. For the reason that arbitral procedures often grant tribunals great discretion in applying substantive law, it is inevitable that foreign arbitrators have to use legal concepts and principles that they are familiar with, but may not necessarily be appropriate, to interpret and apply PRC law (usually in unofficial English translation). Accordingly, conclusions made by tribunals may, at times, depart from clear principles of Chinese law. More importantly, wrongful application of law by an arbitrator leads to the rendering of an erroneous arbitral award, which virtually cannot be corrected.

VII. Offshore Arbitration Faces Difficulties in Enforcement in China

As stated above, in an offshore arbitration, it is difficult for the winning party to apply for preservative or injunctive measures in jurisdictions other than where the arbitration takes place, and this provides the losing party with great opportunity to transfer and conceal its assets in order to evade the enforcement of an award. As a result, when the winning party applies for recognition and enforcement of the award in China, although the court usually recognizes the foreign award, the party may recover nothing through the court, because the party against whom enforcement is sought has disappeared, together with its assets.

Compared to an offshore arbitration, an onshore arbitration has the following advantages: firstly, property and evidence preservation measures are available, enabling a foreign party to obtain relevant evidence and ensuring that the compensation under an award can be recovered; secondly, it is less time-consuming and less costly; thirdly, the tribunal is able, more often than not, to interpret and apply PRC law accurately, so that Chinese legal experts may not be required; fourthly, the award can be enforced directly and efficiently in China without the need of going through the recognition procedure as required in enforcing a foreign award.

At present, some prominent Chinese arbitration institutions, such as the China International Economic and Trade Arbitration Commission (CIETAC), are capable of handling complicated international commercial disputes and have achieved remarkable progress.

Needless to say, the shortcomings of an offshore arbitration as outlined above, if carefully manipulated, may act to the advantage of a party. For example, sometimes a prolonged proceeding will be highly advantageous to a party who wants to buy time, while brutal to the other party seeking an immediate resolution. In addition, high arbitration costs and legal fees may leave the weaker party no choice but to settle.

In short, it is advisable for parties in an international transaction to select an appropriate place of arbitration according to the circumstances of a particular transaction. If the subject of the transaction or the principal assets of the other party are located in the territory of China, foreign clients may be frustrated in enforcing an arbitral award if they select offshore arbitration. Therefore, foreign parties should think twice before opting for offshore arbitration and should consider, on a case-by-case basis, having their business disputes arbitrated in China.

Endnotes

1. China became a contracting state with regard to the New York Convention in 1986.
2. According to the Ministry of Foreign Affairs of China, by March 2008 China concluded ninety-nine bilateral treaties on judicial assistance with more than fifty countries, including France, Italy, Japan, the Republic of Korea, Russia and Spain. In addition, China has also joined the Hague Convention on the Service Abroad of Judicial and Extra-Judicial Documents in Civil or Commercial Matters. These judicial assistance treaties cover service of judicial documents in civil or commercial cases, investigation and collecting evidence and recognition and enforcement of foreign court rulings and arbitral awards, exclusive of the recognition and enforcement of the injunctive orders by foreign judicial branches or arbitration institutes.
3. Article 33 of the ICC Rules of Arbitration provides as follows:

   > A party which proceeds with the arbitration without raising its objection to a failure to comply with any provision of these Rules, or of any other rules applicable to the proceedings, any direction given by the Arbitral Tribunal, or any requirement under the arbitration agreement relating to the constitution of the Arbitral Tribunal, or to the conduct of the proceedings, shall be deemed to have waived its right to object.

4. See Article 4 of Regulations of the Supreme People's Court on Issues Concerning Fees and Duration of Examination of the Recognition and Enforcement of Offshore Arbitration (Fa Shi 1998 No.28), issued by the Supreme People's Court on 14 Nov. 1998.
5. See Article 2 of Notification of the Supreme People's Court Concerning Handling of the Issues Concerning Foreign-related Arbitrations and Foreign Arbitrations by People's Courts (Fa Fa 1995 No.18), issued on 28 Aug. 1995.

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Navigating the CIETAC: A Forum for Resolving Business Disputes in China

By Jie Wang

I. Introduction

International arbitration (or foreign-related arbitration) in China has a history of over fifty years. The arbitration of foreign-related contractual disputes in China started with the China International Economic and Trade Arbitration Commission (the CIETAC) as early as 1956, when CIETAC was established, almost forty years before China promulgated its arbitration law in 1994.

As the first commercial arbitration institution and the only institution that arbitrated international business disputes in China from 1956 to 1995, CIETAC has made tremendous contributions to the development of arbitration in China. Thus both the CIETAC arbitration rules and its practices have been serving as a model for the local arbitration commissions set up after the arbitration law came into effect in 1995.

II. Caseload

During its fifty years of practice, CIETAC has accepted about fifteen thousand cases, involving both domestic parties and foreign-related parties involving more than seventy countries and regions. CIETAC awards have been recognized and enforced in more than thirty foreign jurisdictions. Although its monopoly was broken in 1996, when local arbitration institutions established under the 1994 Arbitration Law were allowed to accept international cases, CIETAC today handles each year a great majority of the foreign-related arbitrations in China.

Since 2004, the caseload of CIETAC has been steadily increasing, setting a new high each year as shown in the following chart.

CIETAC Caseload
2004 - 2009

2004	850
2005	979
2006	981
2007	1118
2008	1230
2009	1482

Up to now, over two hundred local arbitration commissions have been set up, in almost all major cities in China. According to the statistics released by www.china-arbitration.com, alone in 2009 altogether 74,811 arbitration cases were accepted by the two hundred two arbitration commissions, with an aggregate amount in dispute totaling roughly USD 14.33 billion.[1] Among the local institutions, the Beijing Arbitration Commission (the BAC), which is one of largest local institutions, accepted 1,830 cases with an aggregate amount in dispute of USD 1.32 billion. Of these 1,830 cases, seventy-two were foreign-related, which took up about 3.9 percent of its 2009 new caseload. Of the 1,758 domestic cases, 1,215 were cases where both parties are from Beijing while 543 were cases where one party or both parties were from places elsewhere in mainland China. Also in 2009, ten awards made by the BAC were set aside by the people's court, eight awards were sent back by the court for re-arbitration and seven awards were refused of court enforcement.[2]

By comparison, out of the 1,482 new cases accepted by CIETAC in 2009, 559 cases were foreign-related, involving an aggregate amount in dispute of USD 2.58 billion and parties from fifty-four countries and regions. In 2009, out of the 1,329 awards made by CIETAC, only two awards were refused enforcement by the court and none of the awards was set aside by the court.[3]

III. Distinctive Features of CIETAC Arbitration

A. Structural Integrity

As for its structure, CIETAC is not subordinate to any government agency. Affiliated with the China Council for the Promotion of International Trade (the CCPIT, and also called China Chamber of International Commerce, the CCOIC), a non-governmental organization, CIETAC itself is also a non-governmental and non-profit institution, and its arbitrations are free from administrative intervention. Domiciled in Beijing, CIETAC has four sub-commissions in Shanghai, Shenzhen, Chongqing, and Tianjin, respectively, and over twenty liaison offices in other major cities in China. Such a network enables CIETAC to provide convenient arbitration services to parties anywhere in the country.

B. The 2005 Rules

Since its establishment in 1956, CIETAC has updated its rules six times so as to be in line with the international arbitration norms and standards. The present 2005 Rules, effective since 1 May 2005, have included a great number of changes and innovations to enable the parties to enjoy greater party autonomy as well as a fair, flexible and transparent procedure. A few changes that demonstrate the trend toward convergence with international best practices, and which differentiate CIETAC from all other arbitration bodies in China, include the possibility of appointing arbitrators from outside the Panel, a new approach for appointing tribunal chairs, the option of using an adversarial approach for oral hearings, the introduction of dissenting opinions, and the removal of the cap

on recoverable expenses. CIETAC also took measures to ensure arbitrators' independence and impartiality.

Under the 2005 Rules, parties are also free to agree upon a variety of matters, such as the language of arbitration, the seat of arbitration (which could be outside of China), the applicable law, and the nationality of the arbitrators.

C. Arbitrators and Tribunals

CIETAC uses a single panel or list of arbitrators for all types of arbitration cases. There are as many as nine hundred seventy arbitrators listed on the CIETAC roster, comprising experts from specific business and industry sectors as well as academicians and legal professionals. Among the nine hundred seventy arbitrators, more than two hundred seventy are from foreign jurisdictions from more than thirty countries and regions, and about forty arbitrators are from the United States, ten from Australia and two from New Zealand.

A big innovation of the 2005 Rules is that, while maintaining the above broad list of arbitrators as a fundamental reference for the parties (since the present Chinese law requires that an arbitration commission has a panel of arbitrators), CIETAC now allows the parties to appoint arbitrators outside the official CIETAC Panel, provided that both parties have agreed to do so and the appointment is confirmed by the Chairman of CIETAC. This approach of an "ad hoc tribunal" helps the parties enjoy more freedom of arbitration than when ad hoc arbitration had not been allowed in China yet. Furthermore, the 2005 Rules also introduce a new "list" procedure for the parties to appoint the presiding arbitrator. Under this procedure, each party will provide a list of one to three candidates. If an arbitrator appears on both the lists, the arbitrator will be the presiding arbitrator. If no common arbitrator appears on the lists, the third arbitrator will then be appointed by the CIETAC Chairman.

Great efforts have also been made by CIETAC to remain neutral and impartial in appointing arbitrators on behalf of the parties, especially the presiding arbitrators. Under the 2005 Rules, an arbitrator is required to disclose his or her conflicts of interest before accepting an appointment. A supervisory department was set up within CIETAC in 2004 to oversee the arbitrator's compliance with the rules and the ethic code. On top of all these measures, not only have more foreign arbitrators been listed on CIETAC Panel of Arbitrators, but also more arbitrators who are not Chinese have been appointed as the presiding arbitrators. This change, however, by no way suggests that the past practice of appointing Chinese arbitrators as the presiding arbitrators affected or hindered the impartiality and neutrality of CIETAC's administration of the arbitration. As a matter of fact, of all the cases that have been concluded by CIETAC, about half of them were won by non-Chinese parties.

D. Language of Arbitration

Although Chinese is the most commonly used language in CIETAC arbitrations, an agreement between the parties on the language of arbitration will always be honored in CIETAC procedures. As a result, about ten percent of CIETAC cases are heard in English, including some cases where both parties are domestic and the language of arbitration stipulated in the disputed contract is English. Though the figure varies year from year, the use of English as the language of arbitration in CIETAC hearings is undoubtedly on the increase.

E. Application of Other Arbitration Rules

The 2005 Rules allow the parties to agree to use non-CIETAC rules and to amend the CIETAC rules except where the agreement is incapable of being performed or is contrary to a mandatory rule of law at the place of arbitration. This rule eliminates the need to obtain CIETAC's consent for such amendments.

F. Combination of Conciliation and Arbitration

Another outstanding feature of CIETAC arbitration procedure is its combination of conciliation with arbitration, which is a long-time tradition of CIETAC arbitration. This hybrid procedure of "med-arb" is an advantageous mixture of the merits of both arbitration and conciliation and proves to be effective for resolving disputes on the one hand and renewing the business friendship between the parties on the other hand. Each year, about fifteen to twenty percent of CIETAC cases are concluded through conciliation during arbitral proceedings.

The conciliation procedure is not compulsory and is only possible when both parties agree to it. One of the advantages of having the arbitrators act as the conciliators/mediators is that by the time conciliation starts during the arbitral proceedings, the arbitrators are in a unique position to fully understand the dispute and better help the parties to resolve the disputes. In fact, many attorneys who have had their cases concluded through conciliation with the members of the tribunal as the mediators have expressed the view that in retrospect the settlement agreement reached through the conciliation process is the most appropriate arrangement between the parties that could be made for resolving the relevant disputes.

G. Scrutiny of Draft Awards

A CIETAC tribunal is required to submit its draft award to CIETAC for scrutiny. CIETAC has the authority to remind the tribunal of any issue of form or substance, on condition that the tribunal's independence in rendering the award is not affected. This review process, which is similar to that of the ICC, is aimed at doubly guaranteeing the quality of the award and increasing the likelihood of enforceability of the CIETAC awards. Practice shows that larger claims and complex disputes justify the

exercise of such scrutiny over the arbitral tribunal and the arbitration process, and such scrutiny is effective in reducing irregularities in the award that otherwise might undermine its enforceability.

H. Low Costs

CIETAC charges a low arbitration fee, on an ad valorem basis, on both claims and counterclaims in accordance with its fee schedule attached to the rules. Such an arbitration fee covers both the administrative fee of CIETAC and the Chinese arbitrators' remunerations. For the remuneration of a foreign arbitrator sitting in the tribunal, a special fee will be paid by the appointing party to the foreign arbitrator, based on the arbitrator's requirement. Such an arbitration fee is much less than that charged by the ICC, the LCIA, or the HKIAC, especially in light of the inquisitorial nature of most CIETAC hearings, which makes the hearings short, usually lasting for one day.

I. Quality of the Secretariat

CIETAC has a secretariat dealing with all administrative matters in the arbitration proceedings. The secretariat consists of a group of over sixty highly qualified professionals who not only have a law background but also speak at least one foreign language. The outstanding history of CIETAC has given its staff vast and longstanding experience in handling various types of disputes between parties from divergent backgrounds and cultures. With such a secretariat, CIETAC is best placed to efficiently and appropriately handle both international and domestic disputes, allowing the parties and the tribunal to fully focus on the arbitration dispute.

IV. Possible Amendments to the 2005 Rules

In order to better adapt CIETAC to meet the needs of diversified arbitration users and remain competitive internationally and domestically over other arbitration institutions, CIETAC is considering amending its rules for a seventh time and introducing further reforms to its arbitration practice. The seventh amendment is expected to be finished around March of 2011 and will come into effect on 1 May 2011. Following are some of the key amendments.

A. Flexible Determination of the Place of Arbitration and Language of Arbitration

In order to be more international, it is suggested that, where the parties have agreed on the place/language of arbitration, the parties' agreement shall prevail. Absent such agreement, the place of arbitration will not necessarily be the place (*i.e.*, the country) where CIETAC is located and the language of arbitration will not necessarily be Chinese. A decision on the place or language of arbitration will then be made by CIETAC based on the relevant particulars of the case, such as the nationalities of the parties, the nature of the case and the special agreement of the parties, etc.

B. Appointing the Presiding Arbitrator by the Chairman

It is also suggested that the new rules should specify clearly that the Chairman of CIETAC will take into consideration the nationalities of the parties, the nature of the case, etc. when appointing the presiding/sole arbitrator.

C. Appointing Arbitrators in Cases of Multiple Parties

It is suggested that when a case involves multiple parties and the claimants or the respondents are unable to reach an agreement over the appointment of an arbitrator, all members of the tribunal will be appointed by the Chairman of CIETAC.

D. Higher Disputed Amount for Summary Procedure Cases

A disputed amount of RMB 2,000,000 has been suggested as the cutting line between summary procedure and ordinary procedure cases, so that the summary procedure will apply to a case with a disputed amount of less than RMB 2,000,000, instead of the present RMB 500,000.

E. Interim Measures Before Arbitration

The current Chinese Arbitration Law does not clearly endorse nor preclude preservation measures before an arbitration takes place. The present practice of CIETAC is to transfer the application of the claimant for interim measures to the relevant court, as required by the Chinese law, at the same time as when CIETAC sends out a notice of arbitration to both parties. A suggested amendment, aiming to make a breakthrough in this respect within the present legal framework, is to allow CIETAC to make the transfer to the court once the claimant has completed all the formalities for applying for arbitration but before CIETAC sends out the notice of arbitration to the parties.

V. Conclusion

Overall, businesses operating in China are likely to find themselves before a CIETAC arbitration panel in the event of a dispute with a foreign or domestic partner. CIETAC, with its history and experience, and substantive fairness and independence, is always happy to offer its services to the parties.

Endnotes

1. http://www.china-arbitration.com/news.php?id=1743.
2. http://www.bjac.org.cn/en/about_us/2009-2010.html.
3. http://www.cietac.org.

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International Arbitration: Navigating the Arbitral Institutions and Venues

By Professor Doug Jones

I. Introduction

A critical issue in any international arbitration is the location of the arbitral seat or place of arbitration. Beyond the practical issues associated with holding an arbitration in a particular location, the legal environment in which an arbitration operates will be significantly affected by the chosen seat, and this can have a considerable impact on the arbitration. Naturally, parties desire an arbitral seat that (i) will not afford either side an advantage, (ii) is convenient, and (iii) where the legal system has a solid track record of "arbitration-friendliness." However, finding a seat that can offer all these features is not a trivial endeavor. This paper considers the key elements of a "safe" arbitral seat and establishes Sydney as an attractive destination for arbitration.

A recent survey suggests that the most important aspect of arbitral seat-selection is the "formal legal infrastructure" of the seat.[1] This includes the arbitration law of the seat, its attitude towards enforcing arbitral awards, as well as its neutrality and impartiality. Second to the formal legal structure was the convenience of the seat: for example, the availability of judicial assistance. Interestingly, the choice of arbitral institution did not rank very highly in the factors affecting parties' choice. This paper explores the role that an arbitral institution can play in an arbitration, and concludes that the availability of arbitral institutions should indeed be kept in mind by parties when choosing an arbitral seat. In doing this, the significance of the Australian Centre for International Commercial Arbitrations (ACICA) and the Australian International Disputes Centre (AIDC) is explored.

II. Key Characteristics of a "Safe" Arbitral Seat

A. Arbitration Law

The operation of the laws of the arbitral seat governing the arbitration (the *lex arbitri*) must be kept in mind when determining an arbitral seat. It is widely accepted that enforceability of the arbitral award is of paramount importance within the field of international arbitration. Thus, choosing as an arbitral seat a jurisdiction that has enacted the 1985 UNCITRAL *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (the so-called "New York Convention") helps to ensure that the arbitral award will be enforceable in any of the 145 signatory nations.[2] Of course, having enacted the New York Convention is the minimum criteria for selecting a safe arbitral seat. The operation of the *lex arbitri* will have a significant impact on many parts of the arbitration, including procedural aspects such as the taking of evidence and the appointment of arbitrators. This section will look at the development and benefits of the UNCITRAL *Model Law on International Commercial Arbitration* (the "Model Law"), as well as highlighting various essential characteristics of a desirable *lex arbitri*, such as the scope for judicial annulment of arbitral awards.

1. UNCITRAL Model Law

The idea of the Model Law began with a proposal to reform the New York Convention. In 1978, the UNCITRAL Secretariat, the Asian-African Legal Consultative Committee, the International Council for Commercial Arbitration, and the International Chamber of Commerce gathered for a consultation process and were of the "unanimous view that it would be in the interest of international commercial arbitration if UNCITRAL would initiate steps leading to the establishment of uniform standards of arbitral procedure."[3] It was concluded that the preparation of a model law on arbitration would be the most appropriate way of achieving this uniformity.[4] Subsequently, the final text of the Model Law was adopted by resolution in Vienna in June 1985, and a recommendation of the General Assembly of the United Nations commending the Model Law to member states was adopted in December 1985.

In 2006, significant amendments were made to the Model Law. Australia has adopted the model law with the 2006 amendments as the basis of the revised *International Arbitration Act 1974* (the "IAA"). Australia is one of the few countries to adopt the 2006 amendments to the Model Law, along with New Zealand, Ireland, Singapore, Malaysia, Hong Kong (yet to be enacted), India, Mauritius, Peru, Rwanda, and the state of Florida in the United States of America.[5]

Uniformity is a key feature of the Model Law, and it is not difficult to see how having an international standard for the regulation of arbitral proceedings is beneficial to parties to arbitration, arbitrators, legal representatives, and businesspeople around the world in need of a predictable, efficient and effective dispute resolution mechanism. Further, the development of a model law keeps domestic legislatures from redundant expenditure on "re-inventing the wheel" as issues that are common to all arbitral proceedings are addressed.

A key benefit of the Model Law is the flexibility it provides in allowing parties the discretion to agree on various aspects of the arbitral process. For example, Article 19 provides that "[s]ubject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings." Thus, the procedural aspects of an arbitration are left entirely in the hands of the parties. This flexible approach is embraced

throughout the Model Law, with many provisions operating on an opt-out basis. In this, the principles of party autonomy that are paramount to international arbitration are embodied.

2. Availability of Judicial Assistance

It is important to distinguish between judicial interference with the arbitral process and the availability of judicial assistance to support arbitral proceedings. One of the most common uses of the court in supporting arbitral proceedings is in the taking of evidence. While arbitrators can give directions to the effect of requiring adverse disclosure, the power of the tribunal is limited to that granted by the parties. Therefore, should one party require a subpoena or other enforceable evidentiary measures, it is important that the tribunal have the power to approve such a request, and be able to approach the court with the request. The Model Law provides for this, allowing the tribunal or a party with the approval of the tribunal to request the local court's assistance in the taking of evidence.[6]

Other areas where the arbitral process can be supported through the court's assistance include the enforcement of interim measures, as well as assistance in appointing an arbitrator when the parties are unable to come to such an agreement, and have not agreed on an alternative process in such an event. Both of these areas are provided for in the Model Law.[7]

B. Court Attitude to Arbitration

The national courts of the arbitral seat have the potential to impact significantly upon the arbitral process. Even in jurisdictions that, on paper, have progressive arbitration laws, the attitude of the courts will play an essential role in shaping the legal environment in which the arbitration operates. Selecting an arbitral seat where the local courts are friendly to arbitration is fundamental in ensuring a smooth arbitral process.

An example of this can be seen in the controversial European Court of Justice decision in *West Tankers*.[8] In light of this decision, it has been argued that parties concerned about the availability of anti-suit injunctions, and the subsequent difficulties of parallel litigation, may choose to avoid EU seats for their arbitrations.[9]

Australian courts have been recognized, inter alia, as providing independent, objective and experienced decision-makers within the judicial system to decide on arbitration matters.[10] While at various times the Australian judiciary has shown varying degrees of support for arbitration, it is clear that there is a recent trend within Australian courts toward furthering Australia's position as a desirable arbitral seat.

Often, the extent to which the judiciary can interfere with an arbitral award will become a prime consideration in the selection of the seat of an arbitration. Unfortunately, the importance of this aspect of seat selection often becomes significantly clearer with the benefit of hindsight. National courts are normally empowered to review arbitral awards, and different jurisdictions will allow for various degrees of control in this regard, ranging from almost no scope for review to extensive and involved inquiries into both the procedural and substantive decisions made by the tribunal.

Internationally, there is a trend towards the minimization of court interference with arbitral awards.[11] This is reflected in the Model Law, which allows for very limited grounds upon which an award can be challenged.[12] Notably, the Model Law does not allow for judicial review based on the merits of the dispute.

C. Right to Representation of Choice

A critical feature of any "safe" arbitral seat is the capacity of parties to be represented by counsel of their choice without constraints imposed by local bar rules. It is interesting that while the World Trade Organization's General Agreement on Trade in Services (GATS) has 153 signatories,[13] meaningful reform of the legal services industry in regard to allowing foreign lawyers to practice remains the exception among member nations, rather than the norm. The GATS encourages the liberalization of restrictions within the legal services industry, but perhaps due to the lack of policing in enforcing the agreement, and because each member is free to choose its own regulatory objectives, the impact of the GATS is negligible, despite the fact that it was introduced sixteen years ago.

In this regard, Australia's regulation of foreign lawyers wishing to represent a party in an arbitration is indicative of wider changes within the Australian legal profession with regard to the regulatory structure of the profession. There are no requirements for foreign counsel wishing to represent parties to an international arbitration, regardless of whether or not they are admitted to practice as lawyers in other jurisdictions.[14] This ensures that parties have the freedom to choose their representation, unburdened by onerous practicing requirements. Due to the recent enactment of the *Commercial Arbitration Act 2010* (NSW), domestic arbitrations that take place within New South Wales allow parties the freedom to choose any person as their legal representation, regardless of legal qualifications.[15] Until pending reforms are implemented in other Australian jurisdictions, other Australian states allow representation by non-legal practitioners in domestic arbitrations only in certain circumstances.[16]

D. Administrative Assistance

The availability and selection of an arbitral institution should be borne in mind when choosing the arbitral seat, since such institutions commonly provide administrative assistance to the tribunal. For instance, most arbitral institutions provide trained staff to administer the arbitration. Such staff ensure that:[17]

– the arbitral tribunal is appointed;
– advance payments are made in respect of fees and expenses of the arbitrators;
– time limits are satisfied; and
– the arbitration runs as smoothly as possible.

If an arbitration is not administered institutionally, the administrative work will have to be undertaken by the tribunal itself or by a tribunal secretary appointed by the tribunal for that purpose. Further, even where the arbitration is ad hoc, sometimes the parties require that an arbitration institution act as an appointing authority of arbitrators. Therefore a seat that hosts an arbitral institution is preferable over one that does not.

E. Costs

Although relevant to arbitral seat selection, considerations of costs should never be decisive in the choice of the arbitral seat.[18] It is also important to remember that it is possible in many cases to conduct arbitral hearings and meetings in a place other than the arbitral seat for the convenience of the parties. Therefore costs associated with location can be mitigated through this option.

Costs associated with the selection of the arbitral seat generally relate to logistics and can include accommodation, meeting rooms, support services and facilities, transport of people and relevant materials to the seat, telecommunications interpreters, stenographers, secretaries, travel visas, any onerous customs requirements for the import or export of documents or other exhibits needed for hearings, currency regulations and income tax on arbitrator's fees. Costs will be unnecessarily increased if the hearings are conducted in an expensive location.

Taking into account all these potential costs, parties will usually select the arbitral seat based on the legal regime that will facilitate the most predictable and efficient arbitration.[19] The ideal location will also be neutral and objective to avoid providing either party with a systemic advantage over the other.

F. Other Practical Factors

1. Availability of Competent Arbitrators

The quality of an arbitral outcome is dependent on the competence of the arbitral tribunal. However, the availability of experienced and qualified arbitrators will differ depending on the chosen seat of the arbitration. Although it is possible to appoint arbitrators based in jurisdictions other than the arbitral seat, this would require the foreign arbitrators to travel. Consequently, the costs of the arbitration would increase and the process of scheduling hearings or communicating with the foreign arbitrators would be more complex than if the arbitrators were locally situated within the chosen seat of arbitration. Moreover, these consequences are heightened when dealing with multiple arbitrators from different jurisdictions.

2. Availability of Ancillary Services

The availability of ancillary services in a prospective seat for arbitration is another practical matter that should be kept in mind. For instance, the availability of hearing rooms is an issue. Although the arbitral seat is chosen before any hearings are held, it is necessary to fix a specific venue in appropriate premises offered by an arbitral institution, conference centre, or other suitable building. When selecting such a venue, the primary consideration must be to find accommodation that is fit for the purpose.

First, the venue chosen must provide adequate space not only for the tribunal but also for the parties and their legal representatives, documents, and for anyone else assisting in the conduct of the arbitration (i.e. experts, stenographers, and interpreters). Secondly, the venue chosen must be available for the entirety of the period of the hearing it is required for.

The availability of other ancillary services such as experienced local counsel, reporters, translators competent in the languages relevant to the parties and dispute, and international communication facilities such as telephone and internet should also be borne in mind when selecting the arbitral seat.

3. Entry and Exit Requirements of Participants

The following entry and exit requirements of a particular jurisdiction should be considered when selecting an arbitral seat:[20]

- Whether visas are necessary and readily obtainable for the arbitrators, parties and their legal representatives.
- Entry into arbitration site.
- Whether there are onerous customs requirements for the import or export of documents or other exhibits needed for the arbitral hearings.
- Currency regulations.
- Income tax on arbitrator's fees.

III. How Does Sydney Measure Up?

Sydney is a prime venue for an arbitral seat for a myriad of reasons. It offers a compelling combination of sympathetic courts, supportive laws, professional capability, superb facilities and is world-renowned for its distinct character. Sydney also plays host to the headquarters of ACICA, the AIDC and the Australian Chapter of the Chartered Institute of Arbitrators (CIArb) which are able to provide support in the arbitral process.

A. ACICA

ACICA[21] is Australia's international arbitration institution. Established in 1985 as a non-profit public company, the primary objectives of ACICA are to support and facilitate international arbitration and mediation and to promote Sydney and Australia as a venue for both.

Formerly, ACICA's role in administering arbitrations was mainly limited to the appointment of arbitrators and the holding of cost deposits for ad hoc arbitrations under the UNCITRAL Arbitration Rules. This changed significantly in 2005 when ACICA launched its own institutional arbitration rules, known as the ACICA Arbitration Rules, for which it became the administrating body for arbitrations utilizing these rules. In addition to the administration of arbitration proceedings, ACICA offers practical assistance to facilitate arbitration hearings by providing various services such as the provision of hearing facilities, transcription and information technology services. ACICA's educational activities include holding regular seminars and conferences to enhance the knowledge and understanding of international arbitration throughout the Asia-Pacific region.

ACICA operates from three offices in Australia, with its head office in Sydney and a satellite office in each of Melbourne and Perth. ACICA has entered into a number of co-operative arrangements with other international arbitral institutions around the world such as the Singapore International Arbitration Centre, the Hong Kong International Arbitration Centre, the Stockholm Chamber of Commerce - Arbitration Institute and the American Arbitration Association. It is also a founding member of the Asia Pacific Regional Arbitration Group which was established in 2004, a regional federation of over thirty arbitration associations that aims to improve standards and knowledge of international arbitration. In addition, ACICA is also the nominated Australian contact for proceedings under the International Centre for the Settlement of Investment Disputes in Australia.

ACICA also has a co-operation agreement with the Permanent Court of Arbitration (PCA) in the Hague which was signed at the Rio International Council for Commercial Arbitration Conference this year, which is the precursor to a Host country agreement presently being negotiated between Australia and the PCA.

Within Australia, ACICA operates in close co-operation with the AIDC. This relationship enables the two organizations to work together in promoting alternative dispute resolution and offering an efficiently administered full range of commercial dispute resolution services. ACICA also works with the Institute of Arbitrators and Mediators Australia (IAMA) and the CIArb in the education of alternative dispute resolution professionals.

ACICA's Board of Directors is made up of prominent international arbitrators and arbitration practitioners. ACICA's directors are appointed by various bodies, including the Law Council of Australia, the Australian Bar Association, the Chartered Institute of Arbitrators, the Institute of Arbitrators and Mediators Australia, the International Chamber of Commerce Australia, the Attorney-General of the Commonwealth of Australia and the Attorney-General of New South Wales. Other directors are appointed by the corporate members of ACICA and others are ACICA Board nominees.

B. The ACICA Arbitration Rules

In July 2005, ACICA released its own set of arbitration rules.[22] These rules provide an advanced, efficient and flexible framework for the conduct of arbitrations. They draw on a wide range of national and international laws, together with the rules of other leading arbitral institutions. Of particular note is the influence of the UNCITRAL Arbitration Rules,[23] the Swiss Rules of International Arbitration[24] and the UNCITRAL Model Law.[25] They provide a simple and user-friendly system for the conduct of international arbitrations founded on well-tested arbitration rules that have worldwide currency and usage. They also, however, contain numerous provisions that have been specifically tailored for the purposes of international arbitrations seated in Australia.

C. Key features of the ACICA Arbitration Rules

1. Administrative Assistance

Under the ACICA Arbitration Rules, there is a greater degree of administration by ACICA than that which exists under the UNCITRAL Model Law, but it is not as extensive as, for example, under the International Chamber of Commerce Rules of Arbitration.

ACICA is involved in the administration of the arbitral proceedings in a number of ways, including the following.

- ACICA may extend any period of time imposed by the ACICA Arbitration Rules or ACICA in respect of the Notice of Arbitration, the Answer to Notice of Arbitration and the composition of the arbitral tribunal. (Article 3.4).
- ACICA receives the Notice of Arbitration (Article 4). If the Notice of Arbitration is incomplete or is not submitted in the required manner, ACICA may request the Claimant to remedy the defect and delay the date of commencement of the arbitral proceedings until such defect is remedied. (Article 4.5). Upon receipt of a complete and compliant Notice of Arbitration, ACICA will communicate the Notice of Arbitration to the other party. (Article 4.6).
- ACICA receives the Answer to Notice of Arbitration (Article 5). Subsequently, ACICA will provide a copy of the Answer to Notice of Arbitration and any of its exhibits to the Claimant (Article 5.4). Once the registration fee has been paid and all the arbitrators confirmed, ACICA will transmit the file to the tribunal. (Article 5.5).
- ACICA will make available, or arrange for, facilities such as hearing rooms, secretarial assistance and interpretation facilities, and provide assistance for the conduct of the arbitral proceedings as requested by the tribunal or either party. (Article 7).

- If the parties have not or cannot agree on the number of arbitrators then ACICA will decide, taking into account all relevant circumstances. (Article 8).
- ACICA has a significant role in the appointment of arbitrators (Articles 8, 10 and 11). When appointing an arbitrator, ACICA may request information from the parties as it requires to fulfill its function. (Article 12).
- Where the parties do not mutually agree to challenge an arbitrator and the challenged arbitrator does not resign, ACICA will determine the challenge. (Article 14.4).
- Where the parties cannot agree on the arbitrator's hourly rate, ACICA shall determine the rate. (Article 40.2).
- ACICA can maintain trust accounts, which may be utilized by the tribunal to lodge deposits from the parties. (Article 42.5).

2. Confidentiality

Article 18 reflects the dichotomy between privacy and confidentiality. Whereas privacy typically requires that the public be excluded from the hearing, confidentiality refers to a duty of non-disclosure of documents to third parties. Thus Article 18.1, in providing that "[u]nless the parties agree otherwise in writing, all hearings shall take place in private," creates an opt-out rule of privacy. It does not create an immutable rule of confidentiality for all arbitrations under the ACICA Arbitration Rules.

Article 18.2 reflects the Australian jurisprudence on confidentiality in arbitral proceedings. In *Esso v Plowman*,[26] the High Court of Australia held that arbitration proceedings are private, but not confidential, unless the parties expressly agree otherwise. In response, Article 18.2 provides that the parties, the Tribunal and ACICA are all required to treat as confidential all matters relating to the arbitration (including the existence of the arbitration), the award, materials created for the purpose of the arbitration and documents produced by another party in the proceedings and not in the public domain. However, Article 18.2 sets out clearly defined exceptions for when confidentiality does not apply, which include:

- Applications made to competent courts, including for enforcement;
- Disclosure of information/documents pursuant to the order of a court of competent jurisdiction;
- Obligations under any mandatory laws considered applicable by the arbitral tribunal; and
- Compliance with regulatory bodies (such as a stock exchange).

An important expansion of the scope of confidentiality is included in Article 18.4, which requires that the party calling a witness is responsible to ensure that witness maintains the same degree of confidentiality as is required by that party.

3. Interim Measures of Protection

Probably one of the most talked about provisions in the ACICA Arbitration Rules is Article 28, which deals with interim measures of protection. Different to many other arbitration rules that merely empower the arbitral tribunal to order interim measures (or at most provide a very limited definition of interim measures), Article 28 provides a clear and comprehensive definition of the scope of interim measures which are available and sets out the requirements that a party must satisfy in order to obtain such measures.

Article 28 of the Rules follows closely Articles 17 to 17G of the Model Law as amended in 2006, and makes the ACICA Arbitration Rules one of very few arbitration rules available which have incorporated these new concepts. In summary, some of the noteworthy features in relation to interim measures include the following.

- The arbitral tribunal must give reasons for the awarding of interim measures (Article 28.1).
- A clear definition of interim measures, expressly including the provision of security for legal or other costs, which allows a party to easily identify the type of protection that it may seek and all necessary requirements it has to meet (Article 28.2).
- The arbitral tribunal may require the party requesting the interim measures to provide security as a condition to granting the interim measure (Article 28.4).
- If the tribunal later determines that the interim measure should not have been granted, it may decide that the requesting party is liable for any damages caused to the other party by the measures (Article 28.8).

It is worth pointing out that Article 28 of the Rules does not incorporate the very controversial provisions on *ex parte* interim measures and provisional orders that are the subject of Articles 17B and 17C of the Model Law. Article 28.8 further provides clarification that the tribunal's power to grant interim measures does not prejudice a party's right to apply to any competent court for interim measures.

4. Costs

Arbitrators are remunerated on a time-spent basis rather than a fixed fee or fee range based on the amount in dispute, as is the case under many other institutional rules. The wording of Article 40.1, "[u]nless agreed otherwise," suggests that the parties may agree with the arbitrator(s) on a different methodology for the remuneration, although in practice this is very uncommon.

One of the rather noteworthy features of the ACICA Arbitration Rules is that, if the arbitrator(s) and the parties cannot agree on a hourly rate for the arbitrator's remuneration, the hourly rate will be set by ACICA, taking into account the nature of the dispute, the amount in dispute as well as the standing and experience of the arbitrator. (Articles 40.2 and 40.4). As a result, the ACICA Arbitration Rules encourage the parties and arbitrators to reach a consensual agreement regarding the arbitrator's fees.

ACICA's institutional fees consist of a non-refundable registration fee of AUD$2,500.00, which becomes due with the Notice of Arbitration, and an administration fee. (Article 1.2 in Appendix A). The amount of the administration fee is calculated in accordance with Schedule 1 in Appendix A of the ACICA Arbitration Rules and is subject to the amount in dispute. Set out below are the administrative fees as at 20 October 2010:

Amount in Dispute	Administrative Fees
$1 to $500,000	1% of the amount in dispute
$500,001 to $1,000,000	$5,000 plus 0.5% of the amount in dispute above 500,000
$1,000,001 to $10,000,000	$7,500 plus 0.25% of the amount in dispute above $1,000,000
$10,000,001 to $100,000,000	$30,000 plus 0.01% of the amount in dispute above $10,000,000
over $100,000,000	$39,000 plus 0.02% of the amount in dispute above $100,000,000 up to a maximum of $60,000

For the purpose of determining the amount in dispute, claims, counterclaims and set-off defences are added together, but any claims for interest are excluded. If the amount in dispute is not specified in the pleadings, the amount in dispute will be determined by the arbitral tribunal. (Article 2.2 in Appendix A.)

For arbitrations under the ACICA's Expedited Arbitration Rules the registration fee is the same (AUD$2,500.00) but the administrative fees are lower than under the general arbitration rules. (See Schedule 1 in Appendix A of the Expedited Arbitration Rules.)

D. ACICA Expedited Arbitration Rules

Following the successful launch of the ACICA Arbitration Rules, ACICA launched its Expedited Arbitration Rules in late 2008, which have recently been revised in 2010. These rules have been drafted along the lines of ACICA's general arbitration rules, but provide special provisions to facilitate expedited proceedings. The ACICA Expedited Arbitration Rules address the need of parties to have their disputes settled in as cost-effective a manner as possible. To this end, the overriding objective of the ACICA Expedited Arbitration Rules is:[27]

> [T]o provide arbitration that is quick, cost effective and fair, considering especially the amounts in dispute and complexity of issues or facts involved.

In order to achieve this objective, the rules envisage a documents-only procedure in most expedited arbitrations,[28] and generally provide for no disclosure.[29] The ACICA Expedited Arbitration Rules require the statement of claim to be provided with the notice of arbitration, and do not require an answer to the notice of arbitration. They also allow only for the appointment of a single arbitrator, to be appointed by ACICA, in order to minimize opportunities for delay. The ACICA Expedited Arbitration Rules further impose strict time limits on the parties, and there is limited scope for extensions, unless the parties and arbitrator agree otherwise. Significantly, because the arbitrator is subject to a time limit commencing upon his or her appointment, any extension of time during the proceedings will reduce the time the arbitrator has to prepare the award, subject to agreement between the parties.

While expedited proceedings are certainly an important option in the arena of international arbitration, and the efficiency, cost-effectiveness and expedition of such proceedings are frequently realized, regard must be had to the suitability of expedited proceedings in the context of the particulars of each dispute. Expedited proceedings are ideal for smaller disputes, where the amount in question is not too significant. ACICA recommends the use of the ACICA Expedited Arbitration Rules where the disputed amount is less than AUD$250,000.00—with the caveat that, even then, the expedited rules may not be appropriate for "complex, multi-party or multi-issue disputes."[30]

However, when used appropriately, expedited institutional rules have proven themselves a valuable tool in providing effective, cost-efficient and celeritous dispute resolution.

IV. AIDC for Indian, US, Chinese and Other Asian Parties

A. The Australian International Disputes Centre

Australia enjoys close ties to Asia and has stable and robust economic, political and legal environments. However, before the establishment of the AIDC, Australia lacked the specialized infrastructure required to attract disputes away from countries like Singapore, which recently established a dedicated international dispute resolution center. This is no longer the case, now that the AIDC has opened its doors.

Jointly funded by the Commonwealth and New South Wales Governments, ACICA and the Australia Commercial Disputes Centre, the AIDC is now Australia's premier dispute resolution facility. Its establishment will help

Australia attract more international arbitrations, particularly as Australia is well placed to capitalize on the booming global market for cross border dispute resolution.

Functioning as a one-stop shop, the center features world-class communication, audiovisual and video-conferencing facilities, tribunal facilities, conference rooms and access to translation and transcription services. Parties, practitioners and arbitrators making use of the AIDC will receive unparalleled administrative and logistical support that will ensure that the dispute resolution proceedings run effortlessly.

AIDC works with Australia's premier international dispute resolution institutions and organisations including ACICA, CIArb and the ACDC. Moreover, the AIDC is not restricted to solely hosting arbitrations under the ACICA Arbitration Rules. The center is open to facilitate all arbitrations, regardless of the arbitral rules chosen. As such, arbitrations conducted under the American Arbitration Association (or the International Centre for Dispute Resolution), London Court of International Arbitration, China International Economic and Trade Arbitration Commission, Singapore International Arbitration Centre, the Hong Kong International Arbitration Center and UNCITRAL Arbitration Rules are catered for and welcome.

V. Conclusion

Clearly, there are many factors to consider when choosing an arbitral seat. Different parties will have different priorities, but there are some needs that will be universal. The need for a supportive judicial system, affordable and convenient facilities, and the availability of an effective arbitral institution are common to all arbitrations. Care must be taken when choosing an arbitral seat that due consideration is given to each of these factors, and that the importance any one of these factors is not unduly emphasized.

It can be seen that Australia, and in particular Sydney, is certainly a viable option as an arbitral seat. Sydney has the people, the experience, the expertise, the administrative and logistical support, a sophisticated legal system, an accommodating International Arbitration Act and a sound foundation in the Model Law for dispute resolution. It serves as an ideal location for an arbitral seat and a neutral venue for international arbitrations. Parties would be well-advised to keep Sydney in mind when making that vital decision.

Endnotes

1. White & Case, *2010 International Arbitration Survey: Choices in International Arbitration*, available at <http://choices.whitecase.com/> accessed on 22/10/2010.
2. UNCITRAL <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html> accessed on 22/10/2010.
3. UNCITRAL, *Note by the Secretariat: Further work in respect of international commercial arbitration*, 12th sess, UN Doc A/CN.9/169 (11 May 1979) [6].
4. *Id*. at [6]-[9].
5. UNCITRAL <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html> accessed on 22/10/2010.
6. *Model Law*, Art 27.
7. See, respectively, *Model Law*, Arts 17H and 11.
8. *Allianz SpA v West Tankers*, [2009] ECRI-663; 2009 WL 303723.
9. Rainer, *Note: The Impact of West Tankers on Parties' Choice of a Seat of Arbitration*, 95 Cornell L. Rev. 431 (2010).
10. Gary B. Born, International Commercial Arbitration at 1681 (Kluwer Law International 2009).
11. *Id*. at 2638.
12. *Model Law*, Chapter VII.
13. WTO <http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm> accessed on 21/10/2010.
14. *International Arbitration Act 1974* (Cth) Sec. 29.
15. *Commercial Arbitration Act 2010* (NSW) Sec. 24A.
16. *Commercial Arbitration Act 1986* (ACT) see 20; *Commercial Arbitration Act 1984* (NT) see 20; *Commercial Arbitration and Industrial Referral Agreements Act 1986* (SA) see 20; *Commercial Arbitration Act 1986* (TAS) Sec. 20; *Commercial Arbitration Act 1984* (VIC) Sec. 20; *Commercial Arbitration Act 1985* (WA) s 20; *Commercial Arbitration Act 1990* (QLD) Sec. 20.
17. Nigel Blackaby, Constantine Partasides, Alan Redfern and Martin Hunter, Redfern and Hunter on International Arbitration at 56 (Oxford University Press, 5th ed, 2009).
18. Born, note 10 *supra*, at 1684.
19. *Id*. at 1686.
20. Kazuo Iwasaki, Selection of situs: criteria and priorities at 64 (Kluwer Law International, 1986).
21. Further information on the ACICA generally can be found on the ACICA's official website at www.acica.org.au.
22. For an in-depth commentary on the ACICA Arbitration Rules, *see* S R Luttrell & G A Moens, *Commentary on the Arbitration Rules of the Australian Centre for International Commercial Arbitration*, available at www.acica.org.au.
23. Available at <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1976Arbitration_rules.html> accessed on 20/22/2010.
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25. Available at <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration.html> accessed on 20/22/2010.
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27. *ACICA Expedited Arbitration Rules*, Art 3.1.
28. *ACICA Expedited Arbitration Rules*, Art 13.2.
29. *ACICA Expedited Arbitration Rules*, Art 23.4.
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The Recognition and Enforcement of Foreign Arbitral Awards in Korea[1]

By Benjamin Hughes

I. Introduction

Korea ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") on 8 February 1973, and it entered into force there on May 9 of the same year. Since then, Korea's rapid economic development and participation in international commerce has inevitably led to a steady increase in the appearance of Korean parties in international arbitrations. According to the International Chamber of Commerce (ICC), Korean companies were parties in thirty ICC arbitrations in 2008, making Korea third in Asia, after China (including Hong Kong and Macau) and India.[2] Korean parties have also been increasingly active in arbitrations under the rules of the London Court of International Arbitration, the Singapore International Arbitration Centre, the Hong Kong International Arbitration Centre, and other arbitral institutions. This trend looks to continue into the foreseeable future due to rising investment both in Korea by foreigners and by Korean companies overseas.

As Korean companies participate more frequently in international arbitrations, both as claimants and respondents, it is only natural that Korean courts have been called upon more often to enforce foreign arbitral awards in Korea. This article examines the statutory framework and procedural requirements for the recognition and enforcement of foreign arbitral awards in Korea, examines the important Korean court decisions in this area, and discusses some practical procedural considerations for a party wishing to enforce (or resist enforcement of) a foreign arbitral award in Korea. As will be seen, Korean courts are very receptive to the recognition and enforcement of foreign arbitral awards, particularly where the award hails from a jurisdiction which is a signatory to the New York Convention. Most recently, as discussed in detail below, the Korean Supreme Court in 2009 held that foreign arbitral awards from New York Convention jurisdictions have the same res judicata force and effect as a final court decision.[3] Korea is a jurisdiction that is friendly to foreign arbitral awards, regardless of whether such awards are being enforced against a Korean or a foreign party.

II. The Korean Arbitration Act

In 1999, the Korean Arbitration Act (the "Arbitration Act" or the "Act") was amended to substantially adopt the UNCITRAL Model Law. Most provisions of the Arbitration Act are intended to apply only to domestic arbitrations and are beyond the scope of this paper. However, Article 2 of the Act provides that Articles 9, 10, 37 and 39 shall apply to foreign arbitrations (i.e., arbitrations where the seat of the arbitration is outside Korea). All four of these Articles are intended to facilitate foreign arbitrations, rather than to interfere with or limit them.

Article 9 of the Act provides for the dismissal of a court action if there is a valid arbitration agreement. This is intended to prevent a party who has signed a valid arbitration agreement from circumventing that agreement to litigate in the Korean courts. Any party to the arbitration agreement may obtain the dismissal of litigation commenced in Korea by making a prima facie showing of a valid agreement to arbitrate the subject matter of the dispute in Korea or any other jurisdiction. It should be noted, however, that, as in many other jurisdictions, a party bringing a lawsuit in Korea on the merits despite a valid agreement to arbitrate may be deemed to have waived its right to arbitrate the same dispute in subsequent proceedings.

Article 10 of the Act provides that a party to an arbitration may request interim measures from a Korean court. This provision mirrors the provisions of the rules of the ICC and other arbitral institutions, as well as the UNCITRAL Model Law, and is intended to allow a party to seek injunctive relief in order to maintain the status quo pending the resolution of the dispute by the arbitral tribunal, without waiving the right to arbitrate its claims by virtue of resort to the courts. It is often necessary for a party to go to court to seek a preliminary attachment or enjoin a counterparty from disposing of assets which are in dispute. Arbitral tribunals are normally empowered under the applicable rules of the arbitration to grant such relief, but of course are not available prior to the filing of the arbitration or formation of the tribunal. The tribunal also lacks the power to enforce its injunctive orders, so resort to the courts is permitted for these purposes during the arbitration as well.

The articles of the Arbitration Act relevant to the recognition and enforcement of foreign arbitral awards are Articles 37 and 39, which set forth the procedural requirements for obtaining recognition and enforcement of a foreign arbitral award, as well as the standards for determining whether a foreign arbitral award will be enforced in Korea, respectively.

Before discussing these provisions, however, it should be noted that there is no procedure under the Arbitration Act by which a losing party may file an ac-

tion to set aside a foreign arbitral award in Korea. The Arbitration Act does in fact provide procedures for the setting aside of an arbitral award, in Articles 36 and 38 of the Act, but these apply only to domestic arbitral awards. Thus, a foreign arbitral award can be enforced in Korea in accordance with the provisions of Articles 37 and 39, but there is no procedure by which a losing party may petition a Korean court to set aside a foreign arbitral award. A party wishing to challenge the enforceability of a foreign arbitral award in Korea must therefore wait for the winning party to bring an enforcement action. This is a full adversarial litigation, however, during which both parties will have the opportunity to present their case before the court. Of course, depending on the seat of the arbitration, it may be possible to bring an action to set aside the award in that jurisdiction.

Pursuant to Article 37 of the Act, which sets forth the procedural requirements for obtaining recognition or enforcement of a foreign arbitral award, a party applying to a Korean court for such recognition or enforcement must submit (i) the duly authenticated original or a duly certified copy of the arbitral award and (ii) the duly authenticated original or a duly certified copy of the arbitration agreement. If these documents are not in Korean, a duly certified translation must also be submitted. These provisions mirror the provisions of Article IV of the New York Convention, and are the only procedural requirements for the recognition and enforcement of a foreign arbitral award in Korea.

While these procedural requirements are not at all burdensome, Section 37(1) of the Act provides that the recognition or enforcement of a foreign arbitral award is to be granted by the judgment of a court. Thus, absent a judgment from a Korean court recognizing or enforcing the award, a foreign arbitral award may have no practical legal effect in Korea. In addition, the enforcement proceedings may take a substantial amount of time if the losing party is resisting enforcement, since they are subject to appeal all the way to the Supreme Court.

Article 39 of the Act states that the recognition and enforcement of a foreign arbitral award to which the New York Convention applies is to be granted in accordance with that Convention. Foreign arbitral awards from jurisdictions that are not parties to the New York Convention are to be recognized and enforced in accordance with Article 217 of the Code of Civil Procedure and Articles 26(1) and 27 of the Civil Execution Act, which are the provisions applicable to the recognition and enforcement of foreign court judgments.

Because most developed countries are signatories to the New York Convention, this article focuses on the recognition and enforcement of foreign arbitral awards to which the New York Convention applies, but it also discusses the standards for recognition and enforcement under the Code of Civil Procedure and the Civil Execution Act. Finally, some practical procedural considerations are discussed.

III. Foreign Arbitral Awards to which the New York Convention Applies

A. In General

Since Korea is a signatory to the New York Convention, and as provided in Article 39 of the Arbitration Act, Korean courts review applications for the recognition and enforcement of foreign arbitral awards to which the New York Convention applies in accordance with the provisions of that Convention. Korea's application of the New York Convention is not without limit, however. When Korea became a party to the New York Convention in 1973, it made two express limitations to its application. First, Korea stated that it would apply the New York Convention only with respect to arbitral awards made in the territory of another jurisdiction which was party to the New York Convention. Second, Korea limited the application of the New York Convention to commercial disputes, as determined by Korean law. These reservations are quite common among signatories to the New York Convention. As a practical matter, the vast majority of foreign arbitral awards presented for recognition and enforcement in Korea are rendered in a country which is a party to the New York Convention, and concern commercial matters.

Article V of the New York Convention sets forth the very limited grounds that may permit the refusal of recognition and enforcement of an arbitral award. Pursuant to Subsection (1) of Article V, a party may successfully resist recognition and enforcement if such party can prove that (i) the parties were under some legal incapacity, or that the agreement to arbitrate is not valid under applicable law; (ii) the party was not given proper notice of the appointment of the arbitrator or of the proceedings or was otherwise unable to present its case; (iii) the award exceeds the scope of the agreement to arbitrate; (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or the law of the seat of the arbitration; or (v) the award has not yet become binding on the parties, or has been set aside in the country in which, or under the law of which, the award was made. Subsection (2) of Article V provides that recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that (x) the subject matter of the dispute is not capable of settlement by arbitration under the law of that country; or (y) the recognition or enforcement of the award would be contrary to the public policy of that country. Importantly,

an error of fact or law by the tribunal is not a ground for refusal to recognize or enforce a foreign arbitral award under the Convention.

Of the grounds for refusing recognition or enforcement of a foreign arbitral award, the most frequently tested ground in Korea has been that provided under Section V(2)(b) of the New York Convention, i.e, that the recognition or enforcement of the award would be contrary to public policy (under the moniker of "good morals and social order"), although other grounds have also been raised, including lack of proper notice of the arbitral proceedings under Section V(1)(b) and others. Korean courts have proven very friendly to foreign arbitral awards, taking a very narrow view of the exceptional circumstances that are required to successfully resist recognition and enforcement on any of the grounds provided under Article V of the New York Convention.

With respect to the so-called public-policy exception, the Korean Supreme Court in a seminal case in 1990, almost a decade before the revision of Korea's Arbitration Act, adopted a rather restrictive interpretation of "public policy" for the purposes of refusing to recognize and enforce an arbitral award.[4] An arbitral tribunal sitting in London had ordered a Korean company to pay damages in a contractual dispute, and the British party brought enforcement proceedings in Korea. The Korean party (as appellant) argued that enforcement of the award would be contrary to public policy under Section V(2)(b) of the New York Convention because, among other things, (i) it was not present during the arbitration proceedings, (ii) the award did not specify the reasons for the decision, and (iii) the award used U.S. rather than U.K. default interest rates, despite the contract being governed by U.K. law. The appellant also argued that the award should not be enforced pursuant to Section V(1)(b) of the New York Convention because the respondent did not receive proper notice of the arbitral proceedings.

The Korean Supreme Court took a rather dim view of these arguments. For example, with respect to Section V(1)(b), the appellant had argued that it had closed its London office prior to the notice of the arbitration and had therefore not been served with proper notice. It transpired, however, that the British party was able to produce several communications regarding the possibility of a settlement sent by representatives of the appellant from the address of its London office after the arbitration had commenced. Moreover, as the appellant was in fact aware of the proceedings, it suffered no prejudice. The Korean Supreme Court held that Section V(1)(b) of the New York Convention was intended to apply only if there was an egregious and intolerable violation of a party's right to defend itself in the arbitration.

With respect to the respondent's public policy arguments, the Korean Supreme Court held that a violation of "public policy" giving rise to a refusal to enforce a foreign arbitral award under Section V(2)(b) of the New York Convention should be restrictively interpreted in light of the need for certainty and stability in international commercial transactions. The court stated that the so-called "public policy exception" to the enforcement of arbitral awards was intended to protect only the most fundamental moral beliefs and social order in the enforcing country. None of the arguments raised by the respondent reached this standard.

In a subsequent case, in 1995, a Dutch company brought proceedings in the Korean courts to enforce an award rendered in Zurich against a Korean respondent in an arbitration governed by Dutch law.[5] The respondent argued, among other things, that enforcement of the award would be against public policy in Korea because the thirty-year statute of limitations under Dutch law was much longer than under Korean law, where the claim would have been barred. However, the Korean Supreme Court again held that such considerations did not rise to the level of being contrary to public policy. Citing the case discussed above, the court reaffirmed that Section V(2)(b) of the New York Convention should be narrowly interpreted, with due regard for the stability of international commerce, and should be invoked only to protect Korea's most basic moral beliefs and social order. Importantly, the court held that even when foreign laws applied in an arbitration are in violation of the mandatory provisions of Korean law, this did not constitute a reason to refuse enforcement of the award in Korea on the basis of public policy. Only if the actual result of recognizing and enforcing such an award would be contrary to the fundamental morals and basic concepts of justice in Korea should enforcement be refused.

These two cases established an extremely high bar for a party wishing to challenge the recognition and enforcement of a foreign arbitral award on public policy grounds. However, both cases arose from arbitrations that applied foreign law. While the Korean Supreme Court held that the public policy exception would not apply to bar recognition and enforcement simply because the application of foreign law would result in a conflict with mandatory Korean law, it did not address the question of whether Korea has an inherent public policy interest in ensuring the proper application of mandatory Korean law within Korea.

More recently, however, the Seoul High Court addressed this issue, ruling that the same standard should apply even when Korean law is the governing law of the arbitration.[6] The high court stated that recognition and enforcement cannot be refused simply on the basis that implementation of the arbitral award may violate a mandatory provision of Korean law, and again emphasized that, in considering public policy, not only domestic considerations but also the stability

of international commercial transactions should be considered. In reaching this conclusion, the high court cited the Korean Supreme Court cases discussed above, but made no distinction between the application of this principle to arbitrations governed by Korean or foreign law. The Korean Supreme Court subsequently upheld this decision, but on grounds different than were raised on appeal.[7]

B. The *Woodchips* Case

In May 2009, the Korean Supreme Court held that a foreign arbitral award rendered in jurisdiction which is a signatory to the New York Convention is recognized as having the same res judicata effect as a domestic Korean court judgment, unless there are grounds under the New York Convention to refuse recognition and enforcement.[8] In the same decision, the Korean Supreme Court set a very high bar for refusal to recognize and enforce foreign arbitral awards allegedly obtained by fraud.

The case was interesting in many respects, and involved parallel hearings in the civil and criminal courts. The underlying arbitration was an ICC arbitration seated in Hong Kong, involving an exclusive supply agreement. The Claimant, Woodchips, Inc. ("Woodchips"), was a Louisiana company in the business of supplying wood chips, while the Respondent, Donghae Pulp Co. Ltd. ("Donghae"), was a Korean purchaser. Woodchips sought damages for Donghae's failure to make minimum purchases as required under the agreement. As it turned out, there were two versions of the agreement, one in Korean and another in English, the English version having been executed almost two months after the execution of the Korean version. The Korean version of the agreement contained a provision which severely limited the amount of damages Woodchips could claim in a dispute, while the English version did not contain this provision. Naturally, Donghae argued that the Korean version should prevail, and Woodchips argued for the English version.

Donghae had also given Woodchips a blank promissory note in order to guarantee its payment obligations under the agreement. During the arbitration, and before an award was rendered, Woodchips filled in the amount on the promissory note for the full amount of its claim in the arbitration, and presented the check for payment at a bank in Korea. Donghae promptly filed a criminal complaint against Woodchips for forgery of a security instrument, arguing that Woodchips had submitted the note for payment at a value much higher than that permitted under the Korean version of the agreement.

During these criminal proceedings, the arbitral tribunal rendered its award in favor of Woodchips. The tribunal found that the English version was the valid agreement, citing both the unreasonableness of the restrictive provision in the Korean version and the likely understanding of the parties. The Tribunal awarded damages and costs to Woodchips totaling U.S. $8.6 million.

After the Tribunal's award, the Korean criminal court found that Woodchips was guilty of fraud and criminally liable for forgery of the note, because the amount of the promissory note that Woodchips presented for payment was far in excess of the amount of damages permitted under the Korean version of the agreement. The court thus effectively recognized the Korean version as the valid and binding agreement between the parties.

Meanwhile, Donghae had gone into corporate reorganization proceedings in the Ulsan District Court, and Woodchips submitted the arbitral award to the court handling the reorganization proceedings in order to protect its status as a creditor of Donghae. The receiver for the reorganization of Donghae objected, however, on the grounds that the arbitral award was obtained by fraud. Donghae had argued in the arbitration that the English version of the agreement between the parties was a fake agreement that the parties had prepared in order to secure bank loans for the purchase of wood chips, and that Woodchips was falsely claiming that the English version was the real version of the agreement. Woodchips appealed to the Busan High Court, requesting the appellate court to confirm its creditor claim against Donghae on the basis of the arbitral award.

The Busan High Court reviewed the arbitral award de novo, including a detailed review of the factual findings of the tribunal. The court declined to recognize the legal effect of the award in the reorganization proceedings, on the grounds that the award violated public policy under Article V(2)(b) of the New York Convention because it had been obtained by fraud. In its review of the evidence, the court found that Woodchips had fraudulently claimed that the English version of the agreement was valid, and had submitted false evidence in connection with its claims. Undaunted, Woodchips appealed to the Korean Supreme Court.

As noted above, in several prior decisions the Korean Supreme Court had taken a very narrow view of the exceptional circumstances that are required to successfully resist recognition and enforcement of a foreign arbitral award on the basis of a violation of public policy under Article V(2)(b) of the New York Convention. The court had repeatedly held that a violation of public policy giving rise to a refusal to enforce a foreign arbitral award under the New York Convention should be restrictively interpreted in light of the need for certainty and stability in international commercial transactions, thus adopting an international rather than parochial view of public policy. As such, the Korean Supreme Court held that the so-called "pub-

lic policy exception" to the recognition and enforcement of foreign arbitral awards was intended to be invoked only when absolutely necessary to protect Korea's most fundamental moral beliefs and social order.

In the *Woodchips* case, the Korean Supreme Court emphatically reaffirmed its prior holdings, and went a step further. It reversed the Busan High Court on the ground that a foreign arbitral award to which the New York Convention applies has the same legal effect as a final and confirmed judgment of a Korean court. As such, the court held, such an award has res judicata effect in Korea, and, unless there are grounds for refusal of recognition and enforcement under Article V of the New York Convention, the Busan High Court should have issued a judgment confirming Woodchip's creditor claim based upon the foreign arbitral award, without a de novo review of the merits of the case.

Importantly, Woodchips never brought a separate action for the recognition and enforcement of the foreign arbitral award and was not required to do so in order to receive the recognition of its claims in the corporation reorganization suit. While Article 37 of the Arbitration Act requires that the recognition or enforcement of an arbitral award be done through the judgment of a court, it does not specify which court or in what context. In this case, the Korean Supreme Court appears to hold that a claimant may obtain at least recognition of a foreign arbitral award rendered in a New York Convention jurisdiction by submitting the award to the competent court in the context of other litigation, rather than being required to bring a separate action under Article 37 of the Act, and that the court should confirm the award unless there are grounds for refusal under Article V of the New York Convention. Further, the Korean Supreme Court held that the court should refrain from conducting a full reexamination of the case on the merits, and should refuse recognition only in those rare and exceptional cases in which Korea's most basic moral values or social order would be threatened by recognition of the award.

It should also be noted that the Korean Supreme Court rendered its decision without regard for the fact that Woodchips was found guilty of fraud in connection with the forgery of the promissory note, since this was entirely separate from the issues in the arbitration. The charges in the criminal case arose from the fraudulent act of forging the promissory note, not from any fraud in the arbitration itself. The Korean Supreme Court also disregarded the criminal court's finding that the Korean version of the agreement was the valid and binding agreement between the parties.

With respect to the question of fraud in the arbitral proceedings, the Korean Supreme Court rebuked the Busan High Court for exceeding the scope of judicial review of the merits of an arbitral award under Article 5 of the New York Convention. While the courts may review an arbitral award under the Convention, they should not engage in de novo review of the facts and evidence in the arbitration, and their review of the arbitrators' decision should be limited to ensuring that the minimal standards of the Convention are met. The Korean Supreme Court held that courts in Korea may not refuse enforcement of a foreign arbitral award allegedly obtained by fraud unless the fraud can be proven by clear and convincing evidence and is of such a nature that it prevented a party from presenting its case with respect to a material issue in the arbitration. In this case, the Korean Supreme Court found that there was no clear and convincing evidence of fraud, and that each party had a full opportunity to present its case as to which version of the agreement (Korean or English) was valid and binding. Thus, the Busan High Court should not have refused enforcement of the arbitral award under Article 5 of the New York Convention on the grounds that, in its view, the arbitrators may have come to an incorrect conclusion, so long as the parties have had an opportunity to argue this point in the arbitration. The *Woodchips* case thus reaffirmed Korea's stance as a very friendly jurisdiction for the recognition and enforcement of foreign arbitral awards.

IV. Foreign Arbitral Awards Not Subject to the New York Convention

As noted above, Article 39 of the Arbitration Act provides that the recognition and enforcement of foreign arbitral awards to which the New York Convention does not apply is to be determined in accordance with the provisions of Article 217 of the Code of Civil Procedure and Article 26(1) and 27 of the Civil Execution Act, which deal with the recognition and enforcement of foreign court decisions. Thus, foreign arbitral awards rendered in countries that are not signatories to the New York Convention, or awards that deal with disputes that are not commercial in nature, are addressed pursuant to the relevant provisions of Korean law and not the New York Convention. As previously indicated, however, the vast majority of foreign arbitral awards submitted for recognition and enforcement in the Korean courts come from jurisdictions that are parties to the New York Convention and that deal with commercial matters. In fact, to date there has been no published case of which this author is aware testing the recognition and enforcement of a foreign arbitral award pursuant to the Korean Code of Civil Procedure and the Civil Execution Act. Of course, Korean courts have frequently been petitioned to recognize and enforce foreign court decisions, so by extrapolation we may see how they would treat a foreign arbitral award to which the New York Convention does not apply.

First, it should be noted that the grounds for refusing to recognize or enforce a foreign court judgment un-

der Korean law are quite similar to the grounds for refusing to recognize or enforce a foreign arbitral award under the New York Convention. Article 217 of the Code of Civil Procedure ("Effect of Foreign Judgment") provides that a final judgment by a foreign court shall be recognized and enforced provided that it had jurisdiction over the subject matter of the dispute, that the party contesting recognition or enforcement received adequate notice of the proceedings and was able to present its case, and that the judgment does not violate the good morals or social order of Korea. An additional requirement, which is not found in the grounds for enforcement of foreign arbitral awards under the New York Convention, is that there must exist a "reciprocal guarantee," which was for many years taken to mean that the courts in the jurisdiction in which the judgment was rendered must recognize and enforce Korean court judgments by standards that are not substantially different from those provided under the Korean Code of Civil Procedure and other relevant laws. However, this view has been relaxed in subsequent years, and Korean courts are generally inclined to enforce foreign court judgments as long as procedural fairness is assured and there are no public policy concerns. Article 26(1) of the Civil Execution Act requires a judgment of execution by a Korean court in order to execute a foreign award, much like the requirement for a judgment of recognition and enforcement for an arbitral award under Article 37(1) of the Arbitration Act. Article 27 of the Civil Execution Act provides that such a judgment of execution shall be made without an examination of the merits of the case, and that a suit seeking execution shall be dismissed only where the judgment has not been proven to be final and conclusive, or where it fails to fulfill the conditions of Article 217 of the Code of Civil Procedure. These requirements are very similar to the provisions of the New York Convention.

In theory, then, it would appear that Korean courts would be likely to apply a similar standard to the recognition and enforcement of foreign arbitral awards of a commercial nature, regardless of where the award was rendered. As long as the jurisdiction in which the award is made can ensure procedural due process, and recognizes Korean judgments in accordance with reasonable standards, then it would seem that such foreign arbitral awards would enjoy the same deference as awards rendered in jurisdictions which are parties to the New York Convention. The same deference would probably not be afforded, however, to arbitral awards to which the New York Convention does not apply due to the subject matter of the dispute. Korea has specifically excluded non-commercial arbitral awards from its application of the New York Convention due to concerns of sovereignty and the non-arbitrability of certain matters under Korean law. Procedural due process and mutual recognition of judgments would not be relevant to such concerns.

V. Some Procedural Considerations

As a practical matter, a foreign party seeking recognition or enforcement of a foreign arbitral award in Korea will most likely have in hand an arbitral award in English (or some language other than Korean), rendered in a New York Convention jurisdiction, which awards damages in some form (most likely monetary) against a Korean party.

Such a party has ten years from the date of the arbitral award to bring an action for the recognition and enforcement of the award but of course will want to bring the action as soon as possible to obtain the benefits of its hard-fought victory in the arbitration. The first thing the petitioner must do is to obtain a certified translation of the arbitral award and the arbitration agreement pursuant to which the arbitration was conducted. This must be submitted to a court of competent jurisdiction, along with a petition seeking recognition and enforcement. As arbitral awards can be quite lengthy and use legal and technical language, translating the award can be costly and time-consuming.

Next, the petitioner will need to determine which court in Korea is the proper court of jurisdiction over the recognition and enforcement action. Article 7(4) of the Arbitration Act provides that an application for the recognition or enforcement of an arbitral award under Articles 37 through 39 (which includes all foreign arbitral awards) shall be under the jurisdiction of (i) the court designated by the arbitration agreement, (ii) the court with jurisdiction over the place of arbitration, (iii) the court with jurisdiction over the place where a respondent's property is located, or (iv) the court with jurisdiction over a respondent's place of residence or business or place of abode (or last known, if these cannot be determined). Normally, the parties will not have designated a particular court of jurisdiction in the arbitration agreement, and of course if the arbitration is a foreign arbitral award, then by definition there is no court in Korea with jurisdiction over the place of arbitration. Most of the time, the court with jurisdiction over the property of a respondent and the court with jurisdiction over the place of business or residence are the same court, but not always. And most international arbitrations, especially larger cases, involve a party which is subject to jurisdiction in Seoul. In such cases, it is advisable to bring the petition for recognition and enforcement before the Seoul Central District Court, which has a great deal of experience in dealing with foreign arbitral awards and has proven very faithful to the ideals of the New York Convention.

After the petition for recognition and enforcement to the appropriate court of jurisdiction, the respondent (i.e., the losing party in the arbitration, against whom enforcement is sought) will be notified of the petition and given the opportunity to respond. As noted

above, recognition and enforcement proceedings are full adversarial litigation proceedings, and, if the respondent resists enforcement, the court of first instance can take eight to twelve months to render its decision. This decision is subject to appeal by either side to the relevant high court, where the case will be reviewed de novo, and then to the Korean Supreme Court. The process can be quite time consuming and expensive, sometimes taking two or three years (or more), despite the fact that the eventual decision by the Korean courts will most likely be in favor of the party seeking enforcement of the arbitral award. One incentive which keeps losing parties from resisting enforcement by raising and maintaining futile appeals all the way to the Korean Supreme Court, however, is that such respondents are often ordered to pay the costs incurred by the petitioner seeking enforcement of the arbitral award.

Once a Korean court has entered a final judgment recognizing and enforcing the arbitral award, the petitioner may enforce the award against the respondent's assets in Korea, just as it could with a final court order from a Korean court.

VI. Conclusion

The Korean Supreme Court's recent decision in May 2009 is only the most recent in a series of decisions that have established Korea as an extremely friendly jurisdiction for the recognition and enforcement of foreign arbitral awards. Absent strong grounds under Article V of the New York Convention, Korean courts may be expected to recognize and enforce foreign arbitral awards to which the New York Convention applies. The same may be said, at least in theory, with respect to arbitral awards rendered in jurisdictions which are not party to the Convention, provided they meet minimum requirements of procedural due process and recognize Korean judgments by reasonable standards.

Parties should be aware that the recognition and enforcement proceedings in Korea may take considerable time, especially if challenges are raised by the party that lost the arbitration. Nevertheless, Korea is an extremely arbitration-friendly jurisdiction, and Korean courts pay due deference to foreign arbitral awards, especially when the New York Convention applies. One would be hard-pressed to successfully resist recognition or enforcement of a foreign arbitral award absent some egregious breach of procedural due process by the tribunal, or an award which violated the most basic moral values or social order of Korea.

Endnotes

1. A prior, condensed version of this article appeared in the Dong-A Law School's Journal of International Transactions Law (Korea Spring 2010).
2. ICC Bulletin, Vol. 20, No. 1, 2009.
3. Korean Sup. Ct. Dec. No. 2006Da20290, 28 May 2009.
4. Korean Sup. Ct. Dec. No. 89 Daka20252, 10 Apr. 1990.
5. Korean Sup. Ct. Dec. No. 93Da53504, 14 Feb. 1995.
6. Seoul High Ct. Dec. No. 2003Na5513, 5 Dec. 2003.
7. Korean Sup. Ct. Dec. No. 2004Da2649, 27 May 2005.
8. Korean Sup. Ct. Dec. No. 2006Da20290, 28 May 2009.

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Libel Tourism: Balancing Freedom of Speech, Jurisdiction and Comity

By Eric Stenshoel

I. Introduction: The Libel Law Storm

The last few years have seen a flurry of legislative activity in the United States relating to foreign country defamation judgments, beginning with New York's adoption of the "Libel Terrorism Protection Act" in 2008 and culminating in the enactment of the Federal SPEECH Act, which was signed into law by President Obama on 10 August 2010. This paper reviews these developments, examines the motivation for the new laws, and considers the implications of these laws for freedom of speech, standards of international jurisdiction, and comity.

II. State Legislative Developments

New York's new anti-libel tourism act (the "Act") came into effect on 28 April 2008. The law amends New York's Civil Practice Law and Rules (CPLR) to address both the substantive standards for the enforcement of foreign defamation judgments and the jurisdictional standards applicable to declaratory judgment actions for relief from such foreign judgments. Substantively, the Act allows New York courts to deny enforcement of foreign defamation judgments if the law applied by the foreign court did not provide at least as much protection for freedom of speech and press as would have been provided by both the United States and New York constitutions.[1]

Procedurally, it extends New York's long-arm statute to the limits of constitutional due process for the purpose of entertaining declaratory judgment actions for relief from foreign defamation judgments. Such actions may be brought by a New York resident or a person who is amenable to jurisdiction in New York, has assets in New York, or may have to take actions in New York to comply with the foreign judgment, provided that (1) the allegedly defamatory statement was published in New York; and (2) the party seeking the declaratory judgment either (i) has assets in New York that might be used to satisfy the foreign defamation judgment or (ii) may have to take actions in New York to comply with the foreign defamation judgment.[2] The Act applies these changes retroactively, enabling declaratory judgment actions against foreign defamation judgments obtained before its passage.

In the two years since the enactment of New York's libel tourism law, at least three other states followed suit. Illinois was the first, enacting a law which took effect on 19 August 2008.[3] The Illinois law is slightly narrower in jurisdiction, applying only to judgments against residents of Illinois and juridical entities having a place of business there, but is otherwise identical to the New York law. Florida's law, effective 1 July 2009,[4] tracks New York's, except that it does not have retroactive effect. The California law, effective 1 January 2010,[5] is identical to the New York law, including the jurisdictional provision, even though California's long-arm statute already extended personal jurisdiction to its constitutional limit.

III. Federal Legislation

Libel tourism bills were introduced in Congress beginning with the proposed Free Speech Protection Bill (FSPB) in 2008.[6] The FSPB went beyond the New York Act in that it proposed to create a federal cause of action based upon the mere *filing* of a foreign lawsuit for defamation against a "United States person"[7] if the alleged defamatory act would not constitute defamation under United States law, basing jurisdiction over the defamation plaintiff on the plaintiff's service of any documents on the United States person in connection with the foreign lawsuit.[8] The remedies included not only an order of non-enforceability but also damages equal to the amount of the foreign judgment plus costs and other damages for harm to the United States person's ability to publish, conduct research, or generate funding. These damages could be trebled upon a finding that the plaintiff in the foreign action was engaged in a scheme to suppress the rights of freedom of speech and the press. In any event, the FSPB was not enacted into law.

The bill that finally passed both houses of Congress and was signed into law on 10 August 2010 is called the Federal SPEECH Act.[9] Like the FSPB, it prohibits the recognition of foreign defamation judgments if the judgment debtor in the foreign suit would not have been found liable under the standards of United States law and applicable state law. It also prohibits recognition unless the foreign tribunal's exercise of jurisdiction was consistent with the due process requirements of United States law. On both of these issues, the burden of proof is put on the foreign judgment creditor. The SPEECH Act creates a cause of action for a declaratory judgment of unenforceability, but it is based upon the entry of a foreign defamation judgment, not the mere filing of a defamation suit, and it does not provide for damages or other compensation to the plaintiff in the declaratory judgment action, except for the possibility of attorneys' fees. One other point of substantive divergence from the FSPB is that the SPEECH Act specifically insulates Internet service providers to the same extent as if the publication had been in the United States.

Procedurally, the act allows for removal of actions to enforce foreign judgments to federal court and provides for nationwide service of process in declaratory judgment actions. Unlike the FSPB, however, personal jurisdiction is

based on the defendant transacting business or having an agent in the United States, not merely having assets in the United States. The effect of the act is expressly limited to foreign judgments for defamation.

IV. Two Countries Separated by a Common Legal System

The primary focus of the SPEECH Act and its state counterparts has been the differences in defamation law in the United States and the United Kingdom, both in substance and procedure. Although the United States and the United Kingdom share the common law heritage that gave rise to the cause of action for libel, these legislative developments have cast light on how the actions have diverged over time. The key differences were highlighted in testimony given in hearings on the FSPB before a subcommittee of the House Judiciary Committee. [10]

A. Substantive Divergence

Under English law, there is strict liability for defamation.[11] A plaintiff need only prove the defendant's publication of a statement with a defamatory meaning that was directed at the plaintiff.[12] The statement is presumed false unless defendant proves it to be truthful.[13] The defendant's state of mind is irrelevant to the analysis.

British courts do allow some leeway for comment on matters of public concern. The "fair comment" exception protects statements of reasonable opinion based on disclosed, accurate facts and the "responsible journalism" exception protects publishers from liability for some factually inaccuracy in reporting on matters of public interest.[14] The recent case of *Jameel v. Wall Street Journal Europe*[15] suggests that the scope of protection afforded by the responsible journalism exception may be expanding, but the defendant still bears the burden of proving that the exception applies. In *Jameel*, a Saudi businessman and his company sued the Wall Street Journal Europe for defamation based on publication of a story that the businessman's bank account was being monitored for possible links to terrorist organizations. The court held that the publication fell within the responsible journalism exception, since the publisher was able to prove that the story was one of "considerable public importance," that it had acted fairly and reasonably in obtaining and publishing the material, and that the statement at issue made "a proper contribution to the whole thrust of the publication."[16]

Defamation law in the United States has its roots in English law, but the reach of this cause of action was substantially scaled back beginning nearly fifty years ago, when the Supreme Court considered the interaction of defamation with the First Amendment protections of speech and press. First came the landmark case of *New York Times v. Sullivan*,[17] which held that the constitutional interest in "uninhibited, robust, and wide-open" debate on public issues[18] mandated that public officials suing for defamation be required to provide clear and convincing evidence that the defendant acted with "actual malice."[19] Rather than requiring the defendant to prove the truth of the allegedly defamatory statement, the plaintiff has the burden of proof to prove the statement false.[20] By 1990, this heightened constitutional standard was extended to statements about matters of public concern and public figures generally.[21]

B. Procedural Divergence

In addition to fundamental differences in the substantive law of defamation, there are important procedural differences, which were highlighted during consideration of the SPEECH Act. The differences include (i) rules governing the parties' responsibility for the costs of litigation, (ii) the multiple publication rule, (iii) the application of personal jurisdiction, and (iv) the availability of *forum non conveniens*.[22]

1. Fee Shifting

Under English law, the losing party bears the expenses of the litigation.[23] In view of the burden placed on the defendant to prove either the truth of the statement or the applicability of an exception, the potential cost of defense of a defamation claim could be ruinous for an individual author or a small publisher.

2. Multiple Publication

A claim for defamation is based on publication of a false statement, but "publication" is an ambiguous term where the statement appears in multiple books or films, or on multiple computer screens. The rule in New York and most other states in the United States is that a communication in a multiple form constitutes a single communication. This "single publication" rule precludes a plaintiff from bringing multiple lawsuits for defamation based on a single act of aggregate communication.[24] The rule was originally developed for mass publication of written materials, but is now also applied to Internet publications, so that publication is deemed to occur when material is put online, not when it is downloaded by each viewer.[25] The United Kingdom, on the other hand, embraces a multiple publication rule, which counts each and every replication of the statement, including each downloading, as a separate publication giving rise to a claim for defamation.[26] Application of the multiple publication rule has the side effect of extending the statute of limitations as long as the allegedly defamatory statement is available in print or online.[27]

3. Personal Jurisdiction

Under the U.S. interpretation of due process, a court may exercise personal jurisdiction over a non-resident only if the defendant has certain minimum contacts with the forum.[28] In the context of online publication, given a single publication rule for defamation, this means that the online publication at issue must expressly target the

forum state.[29] The multiple publication rule, on the other hand, treats each print dissemination or electronic download of a defamatory statement as a separate tortious act. Under both U.S. and U.K. law, courts have jurisdiction in a forum in which the defendant commits a tortious act but, with the application of the multiple publication rule, it is not necessary that the defendant target the U.K. Even a relative handful of books bought online and website hits will be sufficient to establish jurisdiction.[30] The multiple publication rule and its jurisdictional effect was upheld in Australia in the case of *Dow Jones & Co. v. Gutnick*, where the online paper was written, printed and published in the U.S., and access was limited to paying subscribers, since the paper accepted online subscriptions from residents of Australia.[31]

The multiple publication rule alone is sufficient to subject non-residents to jurisdiction in suits brought in the U.K. by U.K. plaintiffs, even where the defendants would lack sufficient contacts under U.S. standards. The "tourism" aspect of libel tourism arises because British courts are also willing to recognize the right of foreign plaintiffs to protect their reputation in the U.K. For example, in *King v. Lewis*, Don King brought suit in the United Kingdom against Lewis, a New York resident, for libel based on Lewis's allegations of anti-Semitism made against King on a California-based website.[32]

4. Forum non Conveniens

The doctrine of *forum non conveniens* allows a court to abstain from hearing a case, even where it has jurisdiction, if it finds that another jurisdiction would be more appropriate.[33] Once again, however, application of the multiple publication rule will militate against application of the doctrine, since doing so would prevent the adjudication of a tort in the forum in which it ostensibly occurred. Given this perspective, the fact that the defamation action might not survive in the U.S. may itself be an argument against refusing to hear the case on the grounds of *forum non conveniens*.[34]

V. Prior Bases for Non-Recognition

Under the full faith and credit clause, a court in a state that would not recognize the underlying cause of action may nevertheless be obliged to honor a domestic sister state's judgment based on that cause of action.[35] But the United States is not subject to any bilateral or multinational treaty obligations relating to the recognition or enforcement of foreign country judgments and, even though the recognition and enforcement of foreign country judgments is a matter of federal concern, it has remained a matter of state law.[36]

In the absence of more specific legislative guidance, the enforcement of foreign judgments is governed only by the general principle of comity, which the Supreme Court has defined as "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and of the rights of its own citizens…."[37] Each of the recent of libel tourism laws sets out specific grounds for non-recognition of foreign defamation judgments. Under pre-existing law, however, courts were already free to refuse recognition to foreign judgments on the grounds of repugnance to the public policy of the state in which recognition was sought. Courts have not hesitated to deny recognition to foreign country judgments on First Amendment grounds.[38] Indeed, in the *Bachchan* case, the court held that "if…the public policy to which the foreign judgment is repugnant is embodied in the First Amendment…the refusal to recognize the judgment should be, and it is deemed to be, 'constitutionally mandatory.'"[39]

A majority of states have adopted the 1962 Uniform Foreign Money-Judgments Recognition Act and a few have adopted the 2005 Uniform Foreign-Country Money Judgments Recognition Act, but, notwithstanding the name, these acts are in fact not uniform from state to state and are subject to differing interpretations by the highest court of each state.[40] The uniform acts do, however, encode the basic principle that U.S. courts may not recognize judgments of a foreign forum whose procedure is not compatible with the requirements of due process and are allowed to refuse recognition if the judgment or the underlying claim is repugnant to the public policy of the relevant state or the United States. The Declaratory Judgments Act law also already allows U.S. courts to entertain a suit to declare a foreign judgment unenforceable.[41] In other words, the state anti-libel tourism laws did little, if anything, to change the legal landscape of libel in the United States.

VI. The *Ehrenfeld* Case

The event that precipitated the libel law storm was a lawsuit filed in the United Kingdom in 2004 by a Saudi businessman named Khalid Salim bin Mahfouz against Rachael Ehrenfeld, an author living in New York. The lawsuit was based on a statement in Ehrenfeld's book, *Funding Evil: How Terrorism is Financed—And How to Stop It*, that bin Mahfouz had financially supported terrorists prior to 11 September 2001.[42] Jurisdiction was based on bin Mahfouz's reputation in the United Kingdom, where he owned homes and was known to the financial community[43] and, in accordance with the multiple publication rule applied by British courts, publication of the book in the United Kingdom. In this case the publication comprised the sale of approximately twenty-three copies of Ehrenfeld's book in the United Kingdom through online distributors and the publication of the first chapter of the book on the website of ABCNews.com, which was accessible for download in the United Kingdom.[44]

Ehrenfeld chose not to contest the libel suit in the United Kingdom. The British court entered a default judgment against her, finding the statements defama-

tory and false, finding her liable for damages of £30,000 and costs of £30,000, and requiring her to publish an apology and enjoining further publication of the book. Bin Mahfouz never attempted to enforce the judgment against Ehrenfeld in New York, but Ehrenfeld sought a declaratory judgment in federal court in New York against enforcement of the libel judgment against her. The Southern District Court dismissed the suit for lack of jurisdiction under New York's limited long-arm statute.[45]

On appeal, the Second Circuit certified the jurisdictional question to the New York Court of Appeals,[46] which found that service of documents on Ehrenfeld in New York in connection with the British libel suit did not confer personal jurisdiction over bin Mahfouz under New York's existing law.[47] The Court of Appeals distinguished a similar case in the Ninth Circuit, in which Yahoo!, Inc. sought a declaratory judgment of non-recognition of a French court's order forbidding Yahoo! from advertising Nazi paraphernalia on its auction site.[48] In that case, jurisdiction was based on California's statute, which permits the assertion of personal jurisdiction "on any basis not inconsistent with the Constitution."[49] Although the *Yahoo!* case was dismissed as unripe, the majority held that jurisdiction was proper based on the service of papers on Yahoo!.[50] The New York Court of Appeals noted that any argument for expanding New York's rules of personal jurisdiction should be directed to the legislature.[51] Within a few months, the legislature reacted, passing the Libel Terrorism Protection Act.

VII. Jurisdictional issues

In amending New York law to extend personal jurisdiction to the limits of constitutional due process, the legislature of New York adopted the expansive California standard applied by the Ninth Circuit in *Yahoo!*, presumably in the hope that those limits would permit the assertion of jurisdiction based on the service in New York of documents related to a foreign defamation proceeding. The FSPA bill that was introduced in the Senate explicitly based jurisdiction on such service, combined with the existence of assets in the United States against which a foreign judgment could be levied.[52]

The jurisdictional holding in *Yahoo!* is based on an application of the "effects" test that was introduced by the Supreme Court in *Calder v. Jones*.[53] In *Calder*, two employees of the National Enquirer were sued for libel in California by Shirley Jones, the subject of a story that they wrote and edited. The employees' motion to quash service of process for lack of jurisdiction was granted by the Superior Court but the decision was reversed by the California Court of Appeals.[54] On appeal, the Supreme Court held that jurisdiction is proper where a defendant commits an intentional act (i) expressly aimed at the forum state, and (ii) causing harm, the brunt of which is suffered, and which defendant knows is likely to be suffered, in the forum state. In the case of Jones, the article concerned the California activities of a California resident whose career was centered in California, and drew upon California sources. The National Enquirer's circulation in California was substantially higher than in any other state. Under these circumstances, the Court concluded that the brunt of the harm from the article was felt in California.

Interestingly, the defendant-petitioners in *Calder* also raised First Amendment objections to California's assertion of jurisdiction. The Supreme Court rejected the idea that such concerns are relevant to the jurisdictional analysis:

> The infusion of such considerations would needlessly complicate an already imprecise inquiry. Moreover, the potential chill on protected First Amendment activity stemming from libel and defamation actions is already taken into account in the constitutional limitations on the substantive law governing such suits. To reintroduce those concerns at the jurisdictional stage would be a form of double counting.[55]

The Ninth Circuit's application of *Calder's* analysis to the facts of *Yahoo!* was not without objection. As noted by Rendleman,[56] half of the six justices who concurred in the dismissal of the suit did so on the ground of lack of jurisdiction. Justice Tashima noted that the majority position erroneously fails to connect the conduct at issue—the filing of a lawsuit in France—to the requirement that the conduct constitute a contact with the forum state. He points out that, unlike *Calder*, the California contacts resulted not from acts of the declaratory judgment defendant but rather from acts of the French court.[57]

VIII. Factoring in Technology

The widespread availability of electronic communications increases the potential for defamation actions by facilitating both the creation of global reputations and the global publication of statements that may injure those reputations. On the one hand, this technological change may result in liability risks that were unknown only a few decades ago. For example, the application of the multiple publication rule theoretically gives rise to potential liability in a foreign country for off-hand remarks on someone's Facebook page. On the other hand, the same forces make it easier to defend against foreign suits, which is an argument for loosening the requirements for personal jurisdiction, as recognized by the Supreme Court thirty years ago.[58]

Finally, technology may also provide a means to limit the global reach of publication. For example, one commentator, who is critical of U.S. court decisions that apply First Amendment principles to speech directed abroad,

has suggested that application of geographic filtering tools could be used to limit such exposure.[59]

IX. Comity

Considering the pre-existing remedies of non-recognition and declaratory judgment against foreign defamation judgments, the legal effect of the new libel tourism laws appears to be quite limited. In New York, the law extends the reach of personal jurisdiction to the constitutional limits of due process, but in states like California, where the open-ended standard was already in effect, this provision adds nothing to existing law.[60] To the extent that the jurisdictional provisions go beyond the traditional due process analysis of minimum contacts or the targeted effects test of *Calder*, it remains to be seen whether they will survive a constitutional challenge.

The real impact of the libel tourism laws is political rather than legal. They aim to set a standard for non-recognition by declaring that any outcome of a defamation proceeding that is not in accord with First Amendment principles is necessarily repugnant to public policy. In its initial form, the New York legislation would have barred enforcement of foreign judgments unless the foreign jurisdiction provided protection commensurate with that of the First Amendment, which would have categorically invalidated all foreign defamation judgments. In the end, however, the legislature adopted the wording "at least as much protection for freedom of speech and press *in that case* as would be provided by both the United States and New York constitutions."[61] This formulation is more flexible, allowing the court to consider whether the standard actually applied meets constitutional muster. The same flexible standard applies under the SPEECH Act.

Usually, a refusal to recognize and enforce a foreign judgment must be based on more than a claim that any outcome other than the one that would be expected under U.S. law is repugnant to public policy. The defendant in the case of *Sarl Louis Feraud Intern. v. Viewfinder* had defaulted in a French infringement action based on its unauthorized publication on its website of photographs of dress designs that had been shown publicly in France. In the action brought to enforce the French judgment, Viewfinder argued that the French judgment should not be recognized because, unlike France, the United States does not recognize copyright in clothing designs. The Second Circuit rejected this argument, citing a string of precedents for the proposition that:

> The public policy inquiry rarely results in refusal to enforce a judgment unless it is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.… Furthermore, it is well established that mere divergence from American procedure does not render a foreign judgment unenforceable."[62]

Nevertheless, the Court endorsed the proposition that foreign judgments that impinge on First Amendment rights will be found to be repugnant to public policy, citing *Bachchan* and *Yahoo!*.[63]

At first glance, the Second Circuit's formulation appears to be consistent with the legislative statements of repugnance. As pointed out by Professor Silberman, however, such statutory provisions fail to distinguish situations where the public policy exception should apply from others where it should not.[64] In *Telnikoff v Matusevitch*,[65] both parties were residents of England. Telnikoff obtained a libel judgment against Matusevitch based on Matusevitch's statement in a letter that Telnikoff was a racist hatemonger and the publication of the letter in an English newspaper. When Telnikoff sought to enforce his judgment in Maryland, the court refused, citing differences in the libel laws of Maryland and England that implicated First Amendment values. As pointed out in the dissenting opinion, however, it is not clear how public policy requires a court in Maryland to give First Amendment protections to English residents in publications distributed only in England:

> Failure to make our constitutional provision relating to defamation applicable to wholly internal English defamation would not seem to violate fundamental notions of what is decent and just and should not undermine public confidence in the administration of law.[66]

There have in fact been challenges raised by defendants in British libel suits claiming that various aspects of British libel law violate the right to free expression under Article 10 of the European Convention on Human Rights. On appeals to the European Court of Human Rights, however, both the multiple publication rule and the burden of defense have been upheld.[67]

The *Bachchan* case cited by the Second Circuit in *Viewfinder* represents an intermediate situation.[68] There, the libel plaintiff brought suit in England against a news service operating in New York and abroad, alleging that a story that defendant published in both England and New York was defamatory. As in *Telnikoff*, the activity complained of occurred outside the United States, but unlike *Telnikoff*, the libel defendant was a New York resident and some of the relevant events occurred in New York. At least one commentator did not find this nexus sufficiently robust to overcome the United Kingdom's interest in applying its own law of defamation where the relevant publication was in England.[69]

The problem highlighted by critics of the libel tourism laws is that a mandate to analyze the underlying lawsuit by First Amendment standards before enforcing any foreign defamation judgment fails to give serious consideration to the competing interests of the countries

involved. As in *Telnikoff*, the result could be the extraterritorial application of U.S. substantive law. This challenge to the traditional notion of comity would be compounded if courts in the United States, following the lead of *Yahoo!*, begin to assert personal jurisdiction over foreign parties based solely upon the service of papers on a party in the United States pursuant to the rules of a foreign court.

X. Conclusion

On balance, the motivation for the recent legislation on libel tourism appears to be primarily political, with the goal of sending a message to jurisdictions that are friendly to defamation plaintiffs to modify their laws to make them friendlier to publishers and media companies. In this respect, the action may have borne some fruit, as evidenced by libel reform activity in Britain.[70] The net legal effect in the United States, however, is to force courts to analyze the underlying defamation proceeding to ensure that the outcome meets First Amendment standards.

To the extent that the libel tourism acts effect any changes in existing defamation law in the United States, they may face constitutional challenges, particularly with regard to the expansion of personal jurisdiction. If interpreted so as to force the application of U.S. legal principles to cases having no nexus in the United States, they may raise serious concerns about comity. On the other hand, the adoption of the SPEECH Act may also have had the effect of stemming the tide of state libel tourism legislation. It could also conceivably be the first step toward an acknowledgment that the federal government is the appropriate place to deal with the issue of recognition and enforcement of foreign country judgments.

Endnotes

1. CPLR 5304(b)(8).
2. CPLR 302(d).
3. 735 ILCS 5/2-209(b-5) and 5/12-621(b)(7).
4. Fla. Stat. § 55.605 and § 55.6055.
5. Cal. Civ. Proc. Code § 1716(c)(9) and § 1717(c).
6. Free Speech Protection Bill of 2008, S. 2977, H.R. 5814, 110th Cong. § 3(b)(1st Session 2008); Free Speech Protection Bill of 2009, S. 449, 111th Cong. § 3(b)(1st Session 2009).
7. The bill defined a United States person as a U.S. citizen or permanent resident alien, a legal alien residing in the U.S. at the time the allegedly defamatory statement was researched, prepared or disseminated, or a business entity incorporated in, or with its primary location or place of operation in, the U.S. *Id.*, Sec. 5(6).
8. Free Speech Protection Bill of 2008, note 6 *supra*, Sec. 3(b).
9. Securing the Protection of our Enduring and Established Constitutional Heritage Act, or the SPEECH Act, H.R. 2765, Public Law No: 111-223.
10. *See Libel Tourism: Hearing on H.R. 6146 Before the Subcomm. On Commercial and Administrative Law of the H. Comm. On the Judiciary*, 111th Cong. 3 (2009)(written statement of Laura R. Handman, Partner, Davis Wright Tremaine LLP) (hereinafter, "Handman Statement").
11. Rodney A. Smolla, Law of Defamation § 1.9 (2d ed. 1999).
12. Handman Statement, note 10 *supra*.
13. Maly, *Publish at Your Own Risk or Don't Publish at All: Forum Shopping Trends in Libel Litigation Leave the First Amendment Un-guaranteed*, 14 J.L. & Pol'y 883, 900 (2006). This feature of English law was held not to conflict with the *Fourth Section - Case Of Steel and Morris v. The United Kingdom*, European Court of Human Rights Portal. 15 February 2005.
14. *See* Staveley-O'Carroll, *Libel Tourism Laws: Spoiling the Holiday and Saving the First Amendment?*, 4 N.Y.U.J.L. & Liberty, 252, 257-258 (2009).
15. [2006] UKHL 44, [2007] 1 A.C. 359 (appeal taken from Eng.) (H.L.)
16. Staveley-O'Carroll, note 14 *supra*, at 258.
17. 376 U.S. 254 (1964).
18. *Id.* at 270.
19. *Id.* at 280.
20. *Id.* at 282; *Philadelphia Newspapers v. Hepps*, 475 U.S. 767 (1986).
21. *Harte-Hanks Communications, Inc. v. Connaughton*, 491 U.S. 657, 666 (1989); *Milkovich v. Lorain Journal Co.*, 497 U.S. 1, 16 (1990).
22. *See* Staveley-O'Carroll, note 14 *supra*, at 259-265.
23. *Id.* at 259.
24. *See* Restatement (Second) of Torts § 577A (1977); Wood, *Cyber-Defamation and the Single Publication Rule*, 81 B.U.L. Rev. 895 (2001).
25. *See, e.g.*, *Firth v. State*, 775 N.E.2d 463 (N.Y. 2002).
26. *See, e.g.*, *King v. Lewis*, [2004] EWCA Civ. 1329 [¶ 2] (appeal taken from Wales) ("It is common ground that by the law of England the tort of libel is committed where publication takes place, and each publication generates a separate cause of action. The parties also accept that a text on the Internet is published at the place where it is downloaded.").
27. *Compare Firth v. State*, note 25 *supra*, 775 N.E. 2d at 465-66 (libel claim was time-barred because suit was brought more than one year after online posting of the allegedly defamatory material), *with Duke of Brunswick v. Harmer*, (1849) 117 Eng. Rep. 175 (Q.B.) (upholding a libel claim where the Duke's servant obtained a back issue of a newspaper dating back seventeen years), and *Loutchansky v. Times Newspapers Ltd*. [2001] EWCA Civ. 1805, [2002] Q.B. 783, 813, 817-18 (appeal taken from Eng.) (H.L.) (rejecting the single publication rule in the context of Internet publication), *aff'd*, *Times Newspapers Ltd. (Nos. 1 and 2) v. United Kingdom*, 451 Eur. Ct. H.R. (2009) (holding that the multiple publication rule does not violate the right to free expression under Article 10 of the European Convention on Human Rights).
28. *Int'l Shoe v. Washington*, 326 U.S. 310, 316-17 (1945).
29. *See, e.g.*, *Young v. New Haven Advocate*, 315 F.3d 256, 262 (4th Cir. 2002).
30. *Bin Mahfouz v. Ehrenfeld*, [2005] EWCH 1156 (appeal taken from Eng.).
31. *Dow Jones & Co. v. Gutnick*, (2002) 210 C.L.R. 575, 586.
32. *King v. Lewis*, [2004] EWCA Civ. 1329 [¶ 31] (appeal taken from Wales).
33. *See, e.g.*, *Spiliada Maritime Corp. v. Vansulex Ltd*., [1987] A.C. 460 [461].
34. *See, e.g.*, *King v. Lewis*, note 32 *supra*, ¶ 18.
35. Rendleman, *Collecting a Libel Tourist's Defamation Judgment?*, 67 Wash. & Lee L. Rev. 467, 472-73 (2010).
36. *See Libel Tourism: Hearing on H.R. 6146 Before the Subcomm. On Commercial and Administrative Law of the H. Comm. On the Judiciary*, 111th Cong. 3 (2009) (written statement of Prof. Linda J. Silberman, New York University School of Law) (hereinafter "Silberman Statement").
37. *Hilton v. Guyot*, 159 U.S. 13, 163-64 (1895).

38. *Sarl Louis Feraud Int'l. v. Viewfinder Inc.*, 406 F. Supp. 2d 274 (S.D.N.Y. 2005) (hereafter "*Viewfinder*") (denying enforcement of judgment for infringement of clothing design companies' intellectual property rights by defendant's publication of photographs of clothing taken at public event on the grounds of repugnance to public policy for violation of defendant's First Amendment rights), *vacated and remanded*, 489 F.3d 474 (2d Cir. 2007) (directing district court to undertake full fair use analysis of defendant's actions); *Bachchan v. India Abroad Publ'ns Inc.*, 585 N.Y.S.2d 661, 662 (N.Y.Sup.Ct. 1992) (hereinafter "*Bachchan*") (refusing to enforce British libel judgment against New York defendant); *Yahoo!, Inc. v. La Ligue Contre Le Racisme et L'Anitsemisme*, 169 F. Supp. 2d 1181, 1189-90 (N.D. Cal. 2001) (holding unenforceable French judgment rendered under law prohibiting Nazi propaganda because such law would violate the First Amendment), *rev'd on other grounds*, 433 F.3d 1199 (9th Cir. 2006) (en banc).
39. *Bachchan*, note 38 *supra*, 585 N.Y.S.2d at 662.
40. *Id.*
41. 28 U.S.C. § 2201(a); *Aetna Life Insurance Co. v. Haworth*, 300 U.S. 227, 240 (1937).
42. *Bin Mahfouz v. Ehrenfeld*, [2005] UKHC 1156, ¶ 16 (appeal taken from Eng.).
43. *Id.* at ¶ 27.
44. *See Ehrenfeld v. Bin Mahfouz*, 881 N.E.2d 830, 832 (N.Y. 2007).
45. *Ehrenfeld v. Bin Mahfouz*, 2006 WL 1096816 (S.D.N.Y. 26 April 2006) (No. 04 CIV. 9641 (RCC)).
46. *Ehrenfeld v. Bin Mahfouz*, 489 F.3d 542, 545 (2d Cir. 2007).
47. *Ehrenfeld v. Bin Mahfouz*, note 44 *supra*, 881 N.E.2d at 834-36.
48. *Yahoo! Inc. v. La Ligue Contre le Racisme et l'Antisemitisme*, 433 F.3d 1199 (9th Cir. 2006) (en banc) (hereinafter "*Yahoo! Inc.*").
49. CA. CODE CIV. PRO. § 410.10.
50. *Yahoo! Inc.*, note 48 *supra*, 433 F.3d at 1224.
51. *Ehrenfeld v. Bin Mahfouz*, note 44 *supra*, at 834 n. 5.
52. *S. 449*, 111th Cong. 3 (2009), lines 10-18.
53. 465 U.S. 783, 787 n. 6 (1984) (hereinafter "*Calder*").
54. 138 Cal. App. 3d 128, 187 Cal. Rptr. 825 (1982).
55. *Calder*, note 53 supra, 465 U.S. at 790-91.
56. Rendleman, note 35 *supra*, at n. 24.
57. *Yahoo! Inc*. note 48 *supra*, 433 F. 3d at 1232-33.
58. *World Wide Volkswagen v. Woodson*, 444 U.S. 286, 294 (1980).
59. Cooper, Note, *A Tangled Web We Weave: Enforcing International Speech Restrictions in an Online World*, 8 U. PITT. J. TECH. L. & POL'Y 2, 3-4, 21 (2007).
60. Cate, Note, *Chapter 579: The California Anti-Libel Terrorism Act*, 41 MCGEORGE L. REV. 533, 539 (2010).
61. Stavely-O'Carroll, note 14 *supra*, at 284.
62. *Viewfinder*, note 38 *supra*, 406 F. Supp. 2d at 479.
63. *Id.* at 480. The Second Circuit ultimately vacated the district court's refusal to enforce the French judgment, however, remanding the case for a determination of whether the defendant's actions would be subject to a valid fair use defense to copyright infringement under U.S. law.
64. Silberman Statement, note 36 *supra*, at 5.
65. 347 Md. 561, 792 A.2d 250 (Ct.App. 1997) (on certified question from DC Circuit).
66. *Telnikoff v. Matusevitch*, 347 Md. 561, 621-22, 702 A.2d 230, 250-51 (Md. Ct.App. 1997) (Chasanow, J., dissenting).
67. *See, e.g., Times Newspapers Ltd*. (*Nos. 1 and 2*), note 27 *supra* (upholding the United Kingdom's multiple publication rule); *Steel and Morris v. United Kingdom* (No. 68416/01) Eur. Ct. H. R. (2005) (upholding the United Kingdom's placement of the burden of proof on the defendant).
68. *Bachchan*, note 38 *supra*, 585 N.Y.S.2d 661 (N.Y.Sup.Ct. 1992).
69. Stern, *Foreign Judgments and the Freedom of Speech: Look Who's Talking*, 60 BROOK. L. REV. 999, 1033-34.
70. The BBC reported on 4 October 2010, that, according to Attorney General Dominic Grieve, the United Kingdom's coalition government will pursue reform of the country's libel laws. http://www.bbc.co.uk/news/uk-politics-11471378.

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Libel Tourism: An Australian Perspective

By Richard Potter

I. Introduction

This paper is intended to be informative to members of the New York State Bar Association who may not possess a detailed knowledge of the Australian legal system. I will not address in detail any issues already covered in the paper of Eric Stenshoel.

The issue of libel tourism, from a U.S. perspective, has essentially emerged from attempts by individuals to circumvent U.S. libel law by suing on publications (which were for the most part published in the U.S.) in England and then seeking to enforce English monetary judgments in the U.S. against the publisher with assets in that jurisdiction.

Although this phenomenon is not really a serious issue in Australia, in theory a similar situation could arise in view of the inherent similarities with English libel law. I shall briefly examine the legal structure in Australia and describe how Australian courts deal with libel actions concerning publication of the same subject matter within Australia and overseas. I will address also how Australia treats monetary judgments obtained overseas and sought to be enforced in Australia.

Libel tourism is of course a part of the phenomenon of rapidly expanding global communication, which throws up many knotty issues in private international law. Another related issue in Australia is the liability of international search engine providers and ISPs for publication in Australia, and I will also look at this briefly.

II. Australia's Legal System: Is it More Akin to the United States or England?

Australia, unlike England, has a written Constitution,[1] so it may seem to be closer to the US in structure. However, for a number of reasons, the framers of the Australian Constitution chose not to enshrine a Bill of Rights,[2] and therefore there is no equivalent of the freedoms of speech guaranteed by the First and Fourteenth Amendments to the U.S. Constitution.

This is subject to one exception: such a freedom of speech is *implied* into the Australian Constitution where the subject matter concerns matters of politics or government. In the 1990s a number of decisions of the High Court of Australia (Australia's highest appeal court) ultimately led to *Lange v ABC*.[3] In that case the former Prime Minister of New Zealand sued the ABC (Australia's public TV network) for libel. The High Court unanimously held that there was an implied freedom in the Australian Constitution to speak freely on matters of politics and government. However, that this was not a *personal* right of immunity, but rather a right for the courts to determine whether any particular law unacceptably restricted such a freedom. The High Court examined the law of libel in Australia and found that, although that law was a restriction on the implied freedom of speech, it was "reasonably appropriate and adapted" to achieve its objective, which was to strike a balance between freedom of speech and protection of reputation.

At the same time, the High Court expanded the common law defense of qualified privilege to include mass media publications, but only where the publisher could persuade the court that its conduct was *reasonable* in all the circumstances. Such a defense rarely succeeds, since the bar has traditionally been very high for the media. This defense has now been essentially superseded by a statutory defense applicable to any subject matter (as opposed to politics and government).[4]

A. Applicable Law Is Therefore One of Statute and Common Law

Prior to 2005, in Australia the expression "libel tourism," or to put it in more local language, "forum shopping," had a different meaning. It meant a plaintiff choosing to commence proceedings in the most advantageous Australian state or territory where a national publication was concerned. There were eight different state and territorial laws, and a publisher could rely on eight different defenses if it wished. (Other state laws could be utilized as defenses for that part of the publication which took place in each separate state, regardless of where in Australia the proceedings were commenced.)

In 2005, the states and territories made a landmark agreement and identical acts were introduced in each state and territory, with the effect that, although the new laws are state based, because they are identical in substance,[5] there is no need to forum shop. In fact, the multiple state acts (known collectively as the Uniform Defamation Law) expressly restricts such activity.[6]

The law of libel in Australia is therefore more akin to England, but without the freedoms contained in Article 10 of the European Convention of Human Rights.[7] A national Bill of Rights is still a live political issue, but so far the momentum has not been gained to achieve it.

B. A Place for *New York Times v. Sullivan* in Other Common Law Countries?

Despite differing constitutional makeup, there has been detailed consideration of *Sullivan* in other common law jurisdictions. In England, the public figure test was regarded as too stringent in modern conditions and there was great doubt whether the U.K. media would be responsible enough to be given such latitude.[8] In Australia, the High Court said in *Lange*:

> The First Amendment to the United States Constitution prohibits Congress from making any law abridging "the freedom of speech, or of the press". This privilege or immunity of citizens of the United States may not be abridged by the making or "the enforcement" by any State of "any law". That is the effect of the interpretation placed on the Fourteenth Amendment. A civil lawsuit between private parties brought in a State court may involve the State court in the enforcement of a State rule of law which infringes the Fourteenth Amendment. If so, it is no answer that the law in question is the common law of the State, such as its defamation law. The interaction in such cases between the United States Constitution and the State common laws has been said to produce "a constitutional privilege" against the enforcement of State common law.
>
> This constitutional classification has also been used in the United States to support the existence of a federal action for damages arising from certain executive action in violation of "free-standing" constitutional rights, privileges or immunities. On the other hand, in Australia, recovery of loss arising from conduct in excess of constitutional authority has been dealt with under the rubric of the common law, particularly the law of tort.
>
> It makes little sense in Australia to adopt the United States doctrine so as to identify litigation between private parties over their common law rights and liabilities as involving "State law rights". Here, "[w]e act every day on the unexpressed assumption that the one common law surrounds us and applies where it has not been superseded by statute". Moreover, that one common law operates in the federal system established by the Constitution.[9]

In other commonwealth countries, such as Canada, South Africa, New Zealand and India, the *Sullivan* decision was also considered and rejected.[10]

C. Multiple Publication Rule Versus Single Publication Rule

A key differentiation with the U.S. is the adoption in Australia of the multiple publication rule. In *Dow Jones v. Gutnick*,[11] the High Court decided to adopt the same position as England[12] in maintaining the anachronistic rule from *Duke of Brunswick v. Harmer*,[13] where the Duke sent his servant to retrieve an archive copy of a newspaper first published many years before that date and could still sue on it, since the retrieval of this copy was deemed a *new* publication. Only Justice Kirby in *Dow Jones* disagreed with this notion:

> The idea that this court should solve the present problem by reference to judicial remarks in England in a case, decided more than 150 years ago, involving the conduct of the manservant of a duke, despatched to procure a back issue of a newspaper of minuscule circulation, is not immediately appealing to me. The genius of the common law derives from its capacity to adapt the principles of past decisions, by analogical reasoning, to the resolution of entirely new and unforeseen problems.[14]

There is a move to exempt archive records from this rule by statute in England[15] by possibly introducing a single publication rule for such publications and extending the limitation period to balance out the change. To my knowledge this has not yet been adopted there.

III. Treatment in Australia of Mixed Publication within Australia and Overseas

In Australia, the substantive law which must be applied to the commission of a tort is the law of the *lex loci delicti, i.e.*, where the tort was committed, regardless of the fact that an action for such tort or torts is maintainable (as a *forum conveniens*) in Australia.[16] Under the multiple publication rule, each publication in a different country constitutes a separate tort and therefore a defendant is at liberty to seek to apply the law of that country in defense of any claim for damages for publication in that jurisdiction.

A way around the obvious escalation of costs in adducing expert evidence as to the relevant foreign law has been to sue only in New South Wales, for example, but to rely on publication elsewhere as a separate head of *damage* to the claim in New South Wales by way of *republication* of the original tort.[17] Obviously publication must still be proved in each of those jurisdictions, and after *Dow Jones v. Gutnick* actual evidence is required that at least one person downloaded the internet material in that jurisdiction.

IV. Enforcement of Foreign Judgments in Australia

Under the *Commonwealth Foreign Judgments Act* of 1991, judgments of superior courts of certain countries may be registered and enforced in Australia. However the U.S. is not one of those countries.

U.S. judgments can only therefore be enforced if recognized under Australian common law. For this to occur, four conditions must be satisfied: (i) the judgment of the foreign court must have been in the exercise of jurisdiction that is recognized by Australian courts; (ii) the judgment must be final and conclusive; (iii) the parties must be the same in Australia as in the foreign proceeding; (iv) if the foreign judgment is *in personam*, the judgment must be for a fixed

debt. The party seeking to enforce the judgment bears the onus of proving these matters.[18]

V. Liability of Search Engine Providers and ISPs in Australia

In England, a claim against a search engine, Google, for a search result was struck out, since Google was found to have had no role in formulating search terms (it was done through an automated process).[19] Also an action against a number of ISPs, including AOL, failed, since the ISPs' role was purely passive and "for a person to be held responsible there must be knowing involvement in the process of publication of *the relevant words*. It is not enough that a person merely plays a passive instrumental role in the process."[20] An action has been commenced in Victoria against a search engine, Yahoo!, but an interlocutory judgment in May 2010 did not include any strike out by Yahoo! for non-publication.[21] There are, however, significant defenses available to ISPs and search engines for innocent dissemination (as there are in the U.S. and England) if they did not know of the publication at the time.[22]

VI. Comment on Libel Tourism Legislation

The state and federal legislation in the U.S. would seem to have the practical effect of providing immunity for U.S. publishers (as long as their assets remain in the U.S.) for worldwide publication. There is no provision in the SPEECH Act limiting its applicability to articles *primarily* published in the U.S. (which would have addressed any perceived problem of limited publication overseas circumventing U.S. libel law), so it is very broad in its effect. The wording also seems to protect a U.S. citizen based overseas who writes a defamatory article for a foreign newspaper as well as a non-U.S. national who writes a defamatory article for a foreign paper whilst on holiday in the U.S.!

Conversely, U.S. citizens who may themselves be victims of libel may still enjoy the benefits of international forum shopping. For example, the U.S. registered on-line games company, Evony, commenced libel proceedings in Australia against a U.K. resident for an online blog emanating from England, but abandoned its claim on the second day of the trial and now faces a substantial costs order.[23] Another example, provided in Eric Stenshoel's paper, involves the U.S. boxing promoter, Don King, who commenced proceedings in the U.K. against a New York resident (although also a U.K. citizen) for a publication made on a California-based website.[24]

Although there is a review of U.K. libel law taking place as a result of the U.S. legislation, I do not foresee any substantial changes being introduced in the U.K. (or Australia), since it would be difficult to measure what constitutes limited publication, especially in an online world, where it is nearly impossible to see how far and where such a publication will take place.

Endnotes

1. The Australian Constitution was in fact passed by an English Act of Parliament in 1900, the Commonwealth of Australia Constitution Act 1900, which created a Federal Parliament as well as defined the powers of the Executive and Judicature.
2. The official version is that the framers concluded that individual rights were sufficiently protected by other means under common law and responsible government. However, according to Professor George Williams in his book Human Rights under the Australian Constitution (Oxford Uni Press, 2002), a Bill of Rights was undesirable according to contemporary debates, since it might protect citizens such as "Chinamen, Japanese, Hindoos and other barbarians," *i.e.*, those citizens then heavily discriminated against in areas of employment and permitted location of residence.
3. (1997) 189 CLR 520.
4. Section 30 of the Uniform Defamation Law.
5. Procedural issues are still different, *e.g.*, some states have juries and others do not.
6. For example, Section 11 of the Uniform Defamation Law provides that, where there is multiple publication across Australia, then the substantive law must be applied of the state/territory which has the closest connection to the harm suffered, *i.e.*, the residence of plaintiff and the extent of publication are the main factors.
7. Enacted in England through the Human Rights Act 1998. See Article 8, which protects reputation. English libel law has been held not to contravene Article 10, since it balances reputation and free speech: *Times Newspaper Ltd v. United Kingdom* 2005 ECHR, October 11.
8. Neill Report on *Practice and Procedure in Defamation* 1991.
9. (1997) 189 CLR 520 at 563.
10. *See Reynolds v. Times Newspapers*, [1999] 4 All ER 609 at 620, for such a discussion. *See also* Stone and Williams, *Freedom of Speech and Defamation: Developments in the Common Law World*, Monash U. L. Rev. No. 2.
11. (2002) 210 CLR 575 at [128].
12. *See Berezovsky v. Michaels*, [2000] 2 All ER 986 at 993, 1005, 1007–8. *See also Loutchansky v. Times Newspapers Ltd (No 2–5)*, [2002] QB 783 at [62]–[76].
13. (1849) 14 QB 185.
14. *Dow Jones v. Gutnick*, note 11 *supra*, at [92], although Kirby J did not believe there should be an internet specific single publication rule.
15. *Defamation and the Internet: the Multiple Publication Rule*, Consultation Paper CP20/09 (16 September 2009).
16. *Regie National des Usines Renault SA v. Zhang*, [2002] 210 CLR 491.
17. *Toomey v. Mirror Newspapers Ltd*, (1985) 1 NSWLR 173 (at 183); *Habib v. Radio 2UE*, [2009] NSWCA 231 at [126]. This is also the position in England: *Cutler v. McPhail.* [1962] 2 QB 292, 298–299.
18. See *Enforcing Australian Judgments in the USA and vice versa,* 80 ALJ 361 (2006); and Nygh's Conflict of Laws in Australia, Chapter 40 (8th ed.), for more detailed analyses.
19. *Metropolitan International Schools v. Design Technical Corp and Google*, [2009] EWHC 1765 (QB).
20. *Bunt v. Tilley and Ors*, [2006] EWHC 407 (QB) at [23].
21. *Trkulja v. Yahoo! Inc & Anor*, [2010] VSC 215.
22. Clause 91 of Schedule 5 of the *Broadcasting Services Act* 1992 (Cth) for "internet content hosts" and Section 32 of the Uniform Defamation Law.
23. *See* http://www.guardian.co.uk/technology/2010/mar/31/evony-libel-case-bruce-everiss.
24. *King v. Lewis*, [2004] EWCA Civ 1329.

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COMMENTARY

The SPEECH Act: A Contradiction in Terms

By John J. Walsh

I. Introduction

Many thanks to the International Law Section of the New York State Bar Association for allowing me to offer, through this paper, my views on the alleged threat to free speech and free press in America by the phenomenon known as "libel tourism," and the legislative reaction to that alleged threat in the form of the new federal SPEECH Act. That law has been claimed by its sponsors, and in House and Senate Reports, to be necessary to protect American writers and publishers from infringements of their speech rights caused by a certain type of libel suit in foreign courts. Unfortunately, the Act's reach is much more extensive than that.

In this paper, I am not taking a "law review" approach, but the less formal one I would use if I were speaking to you at your Program. Eric Stenshoel's paper, *Libel Tourism - Balancing Freedom of Speech, Jurisdiction and Comity,* provides an excellent overview of the emergence of "libel tourism" as a media and international law phenomenon, and my remarks presume you are familiar with Eric's material.

II. Historical Background

In 2007 I called this phenomenon "The myth of libel tourism" in an article published in the *New York Law Journal* at a time when Rachel Ehrenfeld's campaign to discredit U.K. libel judgments, including the one against her (which she deliberately caused by defaulting) was underway in the U.S. As you know, that campaign failed in the courts, but has achieved success in legislatures, where politicians, ever courting the favor of the media, not judges, hold sway.

With the vigorous support of major American media interests, her campaign achieved a measure of success with the passage of laws in New York, Illinois, Florida and California designed to deny recognition and enforcement of foreign libel judgment against residents of those states (or anyone with assets in those states) unless something highly improbable happens, i.e., the state court finds that the judgment was obtained in a legal structure of substantive and procedural laws comparable to that developed in U.S. law, beginning with the famous 1964 case of *New York Times v. Sullivan.*

Now the U.S. Congress has been persuaded that the "libel tourism" problem—particularly as emanating from the U.K.—has been and is such a threat to American writers, authors and publishers that a federal law should be passed to provide a uniform law throughout the fifty states. I submit that something else has been at work here: Congress has been hoodwinked into passing a major immunity law for American media interests, freeing them from liability concerns caused by foreseeable global publication in the Internet Age, where national boundaries provide no barriers to publication, and defamation laws applicable within those boundaries present risks of exposure to liability that did not exist just a few years ago. That immunity threatens great harm to the mutual respect and comity between nations that is the basis for reciprocal enforcement of each other's court judgments.

III. The SPEECH Act

In the SPEECH Act as passed, Congress made findings that the free expression rights of Americans were being "chilled" by libel suits against "United States author[s] or publisher[s]" in "foreign jurisdiction that do not provide the full extent of free-speech protections to authors and publications that are available in the United States." Another "finding" noted that

> Governments and courts of foreign countries…*have failed to curtail this practice* ["libel tourism"] *of permitting libel lawsuits against United States* persons within their courts and foreign libel judgments inconsistent *with United States first amendment protections* are increasingly common. [Emphasis added.]

I am not a student of international law or the types of relationships between nations to which that law applies, but that last finding seems to me to be breathtakingly arrogant in a world in which, I believe, no other country has adopted U.S. first amendment protections in their laws designed to protect the reputations of individuals and organizations against damaging falsehoods. Why would countries "curtail" their law of defamation, reflecting their view of the value of reputation, because an American person or entity was the defendant? Put another way, why should a country change its view of the social value of reputation, and how to protect it, because an American was the defendant?

Given its emphasis on protecting *American* writing and publishing interests, when one examines the actual terms of the SPEECH Act, some stark contradictions with that loudly proclaimed legislative purpose—the protection of Americans—are immediately evident.

A. The Concept of "Foreign Judgment"

The term "foreign judgment" as defined in the SPEECH Act is not limited to judgments against Americans, nor is it limited to a judgment obtained in a foreign court by a person who meets the generally accepted definition of a "libel tourist"—*i.e.*, a resident of country A who travels to country B to sue an American for publishing a libel about him in B. In short, the foreign judgment could be in favor of a resident of B against another resident of B—a case with no "tourism" whatsoever—but still one where collection of the final judgment requiring enforcement in a U.S. court would be barred. Here is where the mischief created by this law begins.

Consider this hypothetical case: D.F. Hollander, a Dutch citizen and journalist, obtains a temporary work permit to join the U.S. staff of *International Quarterly (IQ),* a magazine focusing on global issues, based in New York City and owned by a Dutch company headquartered in Jakarta. While in the U.S., Hollander researches, conducts interviews, and writes an article which *IQ* publishes in print in every major city in the U.S. and Europe, including the Netherlands, and in its online edition which receives hundreds of thousands of hits from all over the world; the hits are particularly heavy in The Netherlands. In the article, Hollander states that Hans Brinker, also a Dutch citizen, and a national hero in the Netherlands because of his Olympic speed skating medals, is in fact a fanatic ecological terrorist who has taken steps to blow up major dikes and flood the Dutch lowlands to demonstrate what rising oceans caused by global warming will do to coastal lowlands around the world. Brinker sues Hollander for defamation in a Dutch court. Hollander fails to appear and is defaulted, but *IQ's* owner defends on the merits and loses. While preparing the article, Hollander takes steps to transfer his considerable liquid assets and investments to a bank in the U.S. Brinker, who submits evidence that he has no such plans or views, obtains a judgment based on Dutch law against both defendants for €500,000. After the Dutch judgment was rendered, Brinker finds that between them Hollander and *IQ's* owner have less than €50,000 in the Netherlands. Learning of Hollander's asset transfers to the U.S., Brinker hires a lawyer in New York to enforce his judgment. Since the SPEECH Act is in force, what does his lawyer tell him?

Perhaps this: You will not be able to collect because the SPEECH Act's protections are afforded not just to U.S. citizens, but also to aliens lawfully resident in the U.S., and even to aliens temporarily but lawfully resident in the U.S. if the foreign lawsuit's subject matter was "researched, prepared, or disseminated" while that alien was in the U.S. Incredibly, this last provision means that a foreign author, like Hollander, whose published material was researched or written while in the U.S. on a work permit was thought by Congress to be worthy of protection under the U.S. Constitution whenever or wherever outside the U.S. the article he wrote while in the U.S. is published. Brinker, as far from being a "libel tourist" as one can be, is out of luck. Dutch defamation law is not "comparable" to U.S. law, and the evidence on falsity he submitted does not meet U.S. standards. One can imagine foreign authors and reporters intending to write about controversial subjects that will be published in their home country coming to the U.S. to secure this protection while simultaneously keeping assets here to avoid enforcement of a libel judgment issued by a court of the country of their domicile. How is it that a law sold to legislators as a way to protect Americans from harassing lawsuits by "libel tourists" has been written to produce a result where Hollander gets its protection and his fellow citizen Brinker, with demonstrable injury to his reputation, who sued in his own country, gets next to nothing? To make it worse, *IQ* may also be protected by another provision of the Act, despite its appearance and failed defense.

Under the SPEECH Act, a "foreign judgment" for defamation "shall not be recognized or enforced unless a 'domestic court' (both federal and state courts) determines that the foreign court's defamation law applied in the adjudication provides *'at least as much protection for freedom of speech and press in that case as would be provided by' the* U.S. Constitution's first amendment" and by the constitution and law of the State in which the domestic court sits [emphasis added]. This strikes me as requiring nothing more than a *comparison* of the foreign country's substantive libel law and procedure with U.S. law—a comparison that will *always* yield a "no enforcement" result because no other country in the world has libel laws that give as much protection to speech as the U.S. Constitution does. That may be one of the glories of the U.S., but we are alone in doing so. Other countries, with civilized societies and well developed juridical systems, put a higher value on the protection of reputation than we do, and locate the balance point between the value of reputation and speech protection in a different place in their jurisprudence. Is that a valid reason for the U.S. Congress to attempt to cloak every published statement emanating from the U.S.—even those uttered by non-Americans—in our first amendment? I say no—the first amendment's protective zone stops at the U.S. borders and our Congress should not be giving it extraterritorial effect in this backhanded way.

Congress has attempted to mitigate the unqualified comparative law test just described by providing that, even if the foreign libel law failed that test, the successful foreign plaintiff seeking enforcement here could still obtain it by proving that the defendant in the foreign libel suit "would have been found liable for defamation by a domestic court applying" U.S. federal and state constitutional standards. Apparently intended as a gesture to foreign nationals—even "libel tourists"—to get past the compara-

tive law test, this provision raises significant questions. Does the evidence used by the foreign judgment holder seeking enforcement in the U.S. court have to be part of the record evidence received in the foreign court's adjudication? Or can that foreign libel plaintiff proceed under the "less protective" substantive and procedural law of the foreign jurisdiction, obtain the judgment and, if required to come here for enforcement, then proffer other evidence, not used in the foreign proceeding, to meet the *"would* have been found liable for defamation" test? The Act itself provides no procedural guidance. Getting the evidence into the foreign record seems to be the prudent course—assuming that is even possible under the foreign court's procedures and rules of evidence.

B. Jurisdiction

Interestingly, in another provision, the SPEECH Act does seem to impose on the record of the foreign proceeding the U.S. Constitutional due process standards for personal jurisdiction as a test for enforcement. The applicable section seems to be specific in requiring that evidence in support of the foreign court's exercise of personal jurisdiction be in the foreign court's record. Thus the foreign judgment will not be enforceable in the U.S. "[u]nless the domestic court determines that *the exercise of personal jurisdiction* by the foreign court comports with the due process requirements imposed on domestic courts" by the U.S. Constitution. [Emphasis added.]

The interest of the American media in securing passage of the SPEECH Act has been based, without doubt, on its growing alarm that the exponential growth of the Internet has added new, high-risk factors to its defamation liability concerns. Today, what is published in the United States is often published "everywhere." An argument can be made that even printed material prepared for domestic consumption will, foreseeably, be seen by substantial numbers of viewers in any country where that material's subject is found. With most of the rest of the world following the "multiple publication" rule to satisfy that element of traditional defamation law, it is not surprising that American media would like to protect their domestic assets by legislation like the SPEECH Act. But when a newspaper in New York or Washington, D.C., publishes online an article that specifically "targets," *i.e.*, charges, a foreign person or organization with actions that are generally recognized as serious crimes (*e.g.*, fraudulent schemes, violations of human rights, terrorism or its support) with damaging effect on the subject's reputation or business—an article that is foreseeably circulated and read where the "target" resides or does business—why should that person not be able to resort to his country's well-developed law of defamation, including a different rule than the "single publication" rule prevalent in the U.S.? The SPEECH Act is not the answer, but an international treaty or convention on Internet conveyed defamation might provide a workable solution—as long as there are compromises and a meeting of minds somewhere between *Sullivan* and *Reynolds/Jameel.*

C. Extension of Section 230 of the FCC Act

If an online publisher in the U.S. merely presented statements by a third party which are litigated in a foreign libel case, rather than publishing its own content, the SPEECH Act extends the immunity of Internet Service Providers ("ISPs") under Section 230 of the Federal Communications Act of 1934, as amended, to the rest of the world, specifically by prohibiting enforcement of a foreign court's judgment against an ISP in circumstances where Section 230 prohibits a U.S. court from imposing liability. And while proof of "consistency with §230" is also provided here as a loophole to aid the foreign judgment holder, the Act is not at all clear in this provision about the evidence that would allow enforcement.

D. Impact of Appearance in the Foreign Defamation Case

The SPEECH Act goes so far as to afford its full protections against enforcement to a "party" who has appeared in a foreign defamation case—and obviously lost. But again it is unclear as to what is intended. Does an early appearance by counsel (say, to contest jurisdiction or otherwise seek dismissal) followed by default, suffice to gain this protection? What if the "party" (like the hypothetical *IQ)* not only appeared, but defended on the merits and lost? Has that party still the right to have enforcement denied? Has there been a waiver of the Act's benefits even if the "party" contested the merits by offering evidence to prove the truth of his statements? The Act gives no guidance on these issues.

E. Declaratory Judgment Actions

I'm not going to deal with the SPEECH Act's creation of a new type of declaratory judgment action in a U.S. District Court—one that seeks a declaration that the foreign judgment is "repugnant to the Constitution or laws" of the U.S., and allows attorneys' fees if successful—other than to say this: in my view, this new federal civil action will encounter major problems in establishing personal jurisdiction over a foreign libel plaintiff who does no more in the U.S. than serve papers mandated by the foreign court' s procedures—problems which caused Rachel Ehrenfeld's declaratory judgment action to fail in a federal court in New York and in the New York Court of Appeals. In my view, mere service of papers required by a foreign country's court system is not, by itself, the "direct effect" type of "minimum contact" that U.S. constitutional due process requires, and certainly is not the "transaction of business" required by the "long arm" statutes of many states to regulate personal jurisdiction.

F. Federalism Issues

Finally, I believe there may be a serious "federalism" problem lurking in Congress's attempt to apply the SPEECH Act's provisions to the courts of the fifty states. Congress surely has the authority to control the jurisdiction and procedures of the federal courts under Article III of the U.S. Constitution. Our Constitution "enumerates" the legislative "Powers of Congress" in Article I, Section 8. Among those "Powers" is: "To regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes."

One commentator has suggested that passing laws regulating enforcement of foreign libel judgments by state courts falls under the power to regulate "commerce with foreign nations." I think that may be a hard sell. The intercourse between friendly nations—the "comity"—that is the basis for mutual recognition and enforcement of each other's court judgments seems to me to be much more an aspect of inter-governmental political relationships and diplomacy—the realm of the State Department in the Executive Branch. If enforcement of foreign judgments based on tort law is not "commerce," the Tenth Amendment to the U.S. Constitution, which reserves to the states all legislative powers except those "enumerated" in Article I, Section 8, would seem to apply. Establishing policies and procedures for its own courts seems to be a basic element of the sovereignty of each of our states within our federal system. Unless the foreign or interstate commerce clauses ("enumerated" powers) can be construed to include telling states which foreign tort judgments they can enforce or not enforce, that legislative authority must repose with the relevant state's legislature. Indeed, the New York, Illinois, Florida and California legislatures undoubtedly believe they have already done that. And conversely, if the "foreign commerce" theory is correct, those states have likely exercised a power now pre-empted by an explicit act of Congress. There may be more work for the U.S. Supreme Court here.

IV. Conclusion

Indeed, as I see it, many questions about the reach of and constitutional basis for the SPEECH Act lie ahead. This is a shame because this federal law is so unnecessary! There is no tidal wave of foreign libel judgments rolling towards American shores—the existing case law numbers fewer than a dozen over the decades since *Sullivan* was decided in 1964. Because the U.S. Constitution is the supreme law of the land, state courts have turned to first amendment analysis in those cases without the need for a command of federal legislation.

Many will argue that all the SPEECH Act does is enforce the application of that "supreme law" in state courts. In my view that does not necessarily result in an automatic barrier to enforcement of foreign libel judgments, although state court perceptions of the first amendment's commands have carried the day to deny enforcement in most of the cases already decided. International comity as public policy has received short shrift in those few decisions, but a state has, and all of them collectively have, a legitimate interest in having the judgments which its courts render in favor of its citizens enforced in other countries, if necessary. What the U.S.A.'s relationships with other nations do not need at this time is the poke in the eye with a sharp stick that Congress has given by explicitly accusing our closest friends in the international community—including the U.K and the "special relationship" we have with it—of failing to protect free expression "American style," when they have no reason whatsoever to do that.

My friend and colleague Paul Tweed, senior partner of Johnsons Solicitors of Belfast, London and Dublin, and a prominent media lawyer who served on the U.K. Ministry of Justice Libel Working Group, has written a commentary which I have attached as an appendix. It succinctly and trenchantly gives a view from "across the pond" about the potential effects of the SPEECH Act on our two nations' future ability to cooperate, based on principles of reciprocity and comity, in recognizing and enforcing each others' court judgments in many areas—not just defamation. He believes that some reforms of U.K. libel law will be enacted—but also that *New York Times v. Sullivan* is not likely to show up as a controlling precedent in the U.K. anytime soon or in the foreseeable future.

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Appendix

Remarks of Paul Tweed of Johnson Solicitors

From a UK perspective, the legislation passed recently in the United States is offensive to every basic principle of international jurisdiction and comity, not to mention the "special relationship" that has existed between our two countries for many years. One must ask the question as to how the US would react if the UK legislators were to introduce a similar counterprovision whereby any US judgments that were deemed offensive or unenforceable by a British court would not be recognized here in the UK. For instance, on this side of the Atlantic many find the massive awards of punitive damages we often read about to be both bewildering and unjustifiable on any basic principle of justice. If say BP were to be at the receiving end of an award of such punitive damages arising out of the oil spill in the Mexican Gulf, I am sure any American plaintiffs would expect to be in a position to enforce against BP's assets in the UK and Europe.

Furthermore, the exorbitant contingency fees normally deducted by attorneys in the US would be unacceptable in the UK jurisdiction, and in the light of the legislation directed against UK libel laws, we have to think of the analogy of "what's sauce for the goose is sauce for the gander"!

However, perhaps an even more pertinent point to raise is whether there was in fact a "problem" to be addressed in the first place. Recent research has confirmed that last year there were no more than three Actions that could be potentially classified as "libel tourism," which represented a very minor proportion of the total case load of the High Court in London. Why then has there been such a frenzy in media and political circles in the US? Certainly Rachel Ehrenfeld and her supporters managed to organize what was probably one of the most effective lobbying campaigns since that orchestrated by the tobacco industry some years ago, and then the press (on both sides of the Atlantic) seized the opportunity to deter any potential threat to their financial profitability, notwithstanding the fact that, in my opinion, the UK press broadsheets are among the most credible in the world, in no small measure due to our libel laws!

I should say that this is in stark contrast to my experience at the hands of many of the US broadsheets, who have pointblankly refused to afford me or any of my colleagues any right of reply to what can only be described as one-sided propaganda in covering the libel tourism debate. I met with a similar response to my pleas for a right to be heard before the Senate Judiciary Hearings, which again appear only to have been interested in hearing one side of the argument.

While at the end of the day, the US legislation may to a large extent be merely symbolic, I nonetheless firmly believe that this blatant attempt to undermine and interfere with another nation's laws will rebound on the US legislators, with other countries now more minded to pay particular attention to requests for the enforcement of judgments from the US courts.

Anti-Tax-Avoidance Regimes for Trusts: The U.S. Perspective

By Glenn G. Fox and Paul A. Ferrara

I. Introduction

In this article we discuss the various regimes established by Congress and the Department of the Treasury to combat avoidance of U.S. income taxation through the use of foreign trusts. We outline the circumstances under which a foreign trust, be it outbound or inbound, is deemed a grantor or nongrantor trust for U.S. tax purposes, and we describe the U.S. income tax implications with regard to each. We also provide an overview of the so-called "throwback rules," which prevent U.S. persons from using foreign nongrantor trusts to accumulate income without current income tax.

In addition, we summarize the U.S. reporting requirements regarding distributions to a U.S. person from a foreign trust and gifts to a U.S. person from a foreign person, as well as the rules governing the nature and imposition of penalties for failure to comply with the U.S. reporting requirements. We also delineate the U.S. reporting requirements with regard to foreign accounts in which a U.S. person has a financial interest or signature authority and the rules governing the nature and imposition of penalties for failure to comply with these U.S. reporting requirements.

II. U.S. Income Taxation of Foreign Trusts and Their U.S. Beneficiaries

A. Introduction

A trust will be considered a U.S. person if a court within the U.S. is able to exercise primary supervision over the administration of the trust (the "court test") *and* one or more U.S. persons have the authority to control all substantial decisions of the trust (the "control test").[1] Any trust which is not a U.S. person (i.e., a trust that does not meet both the court test and the control test) is considered a foreign trust for U.S. tax purposes.[2]

The manner in which the income of a foreign trust is taxed for U.S. tax purposes depends upon whether the trust is a grantor trust or a nongrantor trust. A discussion of these two types of trusts follows below.

B. Taxation of Foreign Grantor Trusts

If a trust is a grantor trust, a particular person is treated as the owner of the trust, and the income, deductions, and credits against tax of the trust will be attributed to that person and, therefore, included in computing that person's taxable income and credits.[3] There are a number of sections of the Internal Revenue Code that result in a trust's being considered a grantor trust. One such section is Section 679. Under Section 679, a U.S. person generally is treated as the owner of a foreign trust, and such a trust is therefore considered a foreign grantor trust, if (i) the U.S. person transfers property to the foreign trust, and (ii) the trust could benefit a U.S. person.[4] (Note that it is immaterial for purposes of Section 679 whether the trust is created for the benefit of the owner or for the benefit of a third party, as long as some U.S. person may be benefited.)

If a nonresident alien of the U.S. ("NRA") has a residency-starting date within five years after directly or indirectly transferring property to a foreign trust, such person is treated as if he or she transferred to such trust on the residency-starting date an amount equal to the portion of such trust attributable to the property transferred by him or her to such trust in such transfer.[5] Therefore, the trust will be treated as a grantor trust as to such individual once he or she immigrates to the U.S., thereby preventing such individual from sheltering assets from the income tax by transferring them to a foreign trust prior to his or her arrival in the U.S.

All foreign trusts are presumed by the U.S. Internal Revenue Service (IRS) to benefit a U.S. person unless the transferor can establish that (i) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a U.S. person, *and* (ii) no part of the income or corpus of such trust could be paid to or for the benefit of a U.S. person were the trust to terminate at any time during the taxable year.[6] Pursuant to flush language added to Section 679(c)(1) in 2010, trust income is deemed to be accumulated during the taxable year to or for the benefit of a U.S. person *even if the U.S. person's interest in the trust is merely contingent on a future event*.

A beneficiary is not treated as a United States person for the purpose of the above rules with respect to any transfer of property to a foreign trust if that beneficiary first became a U.S. person more than five years after the date of the transfer.[7]

Furthermore, if a U.S. person is a beneficiary of a foreign trust and that person transfers property to an entity in which the foreign trust holds an ownership interest, the transfer is treated as a transfer of such property by the U.S. person to the foreign trust, followed by a transfer of the property from the trust to the entity owned by the trust (unless it can be demonstrated that the U.S. person owns an interest in the entity directly).[8]

C. Taxation of Foreign Nongrantor Trusts

Although the income of a foreign grantor trust (like that of all grantor trusts) is attributed to the owner of the trust, resulting in the trust's effectively being ignored as a separate taxpayer for income tax purposes, the income of a foreign nongrantor trust (like the income of a domestic nongrantor trust) is taxed to the trust, to the trust's beneficiaries, or partly to each. Income is allocated between a foreign nongrantor trust and its beneficiaries through the concept of distributable net income (DNI) and its limitation on the trust's distribution deduction. DNI for a foreign trust is, generally speaking, the taxable income of the trust, including capital gains.[9]

A foreign nongrantor trust, like a domestic nongrantor trust, can be either a "simple trust" or a "complex trust." A foreign nongrantor trust is a simple trust if (i) all income must be distributed currently; (ii) no amounts may be paid to, permanently set aside for, or used for a charitable beneficiary; and (iii) no distributions are made other than of current income (i.e., no distributions are made of accumulated income or corpus).[10] All of the income of a simple foreign nongrantor trust will be taxed to the beneficiaries. For current income payable to the beneficiaries, the trust will receive a deduction, whether or not that income is actually distributed.[11] The amount included in the beneficiaries' gross income and the amount of the trust's deduction are both limited by the trust's DNI.[12]

A foreign nongrantor trust that is not required to distribute all of its income currently, that distributes accumulated income or principal, or that has a charitable beneficiary is a "complex" trust. A complex foreign nongrantor trust receives a deduction for that portion of its current income that the trust is required to distribute plus any other amounts that the trustee actually distributes during the taxable year to the beneficiaries pursuant to the governing instrument.[13] The trust's deduction is limited to the amount of its DNI.[14]

The beneficiaries of a complex foreign trust include in their gross income all income that the trust is required to distribute plus any other amounts that the trustee actually distributes during the taxable year to the beneficiaries pursuant to the governing instrument.[15] Each beneficiary must include in his or her gross income an amount equal to that beneficiary's pro-rata share of the trust's DNI.[16] A distribution in excess of the trust's DNI is treated as either a nontaxable distribution of principal or a distribution of income accumulated from prior years taxable under the so-called "throwback rules."[17]

The purpose of the throwback rules is to prevent U.S. persons from using foreign nongrantor trusts to accumulate income without current tax. Under the throwback rules, the U.S. taxes a U.S. beneficiary of a foreign nongrantor trust making so-called "accumulation distributions" in the same manner that the U.S. would have taxed the beneficiary if the trust had distributed all of its income on a current basis.[18] An "accumulation distribution" is a distribution of any amount from the trust, other than income that is required to be distributed from the trust, to the extent that the amount distributed exceeds the trust's DNI for the year, reduced by income that is required to be distributed.[19] A U.S. beneficiary of a foreign trust who receives an accumulation distribution is adversely affected in two ways, for not only is the entire distribution taxed at the ordinary income rate rather than the lower capital gains rate, but it also is subject to an interest surcharge.

The throwback tax on an accumulation distribution is determined by averaging the distributions over a number of years equal to that over which the income was earned and by including a fraction of the income received from the trust in the beneficiary's income for each of the five preceding years, excluding the years with the highest taxable income and the lowest taxable income. The fraction of income included in the five years is based on the number of years the income was accumulated.[20] In addition to the tax on the accumulation distribution, the beneficiary who receives an accumulation distribution has an interest surcharge imposed on the throwback tax equal to the rate of interest applicable to underpayments of tax (which is the Federal short-term rate as determined monthly, plus three percent).[21]

D. Special Rules If Grantor Is a Foreign Person

In the case of trusts having a foreign grantor—so-called "inbound grantor trusts with foreign grantors"—Section 672(f) applies special rules that make it difficult for a foreign person to be treated as the owner of a trust for income tax purposes under the grantor trust rules. This, in many instances, prevents a foreign person from creating a foreign trust for U.S. beneficiaries and taking the position that he is the owner of the trust for income tax purposes.

A trust, be it foreign or domestic, is treated as a grantor trust with respect to transfers after 19 August 1996 only if the person deemed to own the trust is a U.S. person or a domestic corporation.[22] This rule applies whether the trust income would be imputed to the foreign person either "directly or through 1 or more entities."[23] Prior to the enactment of Section 672(f), a foreign grantor could use a foreign trust to convert into a tax-free distribution a gift to U.S. beneficiaries of assets—say, foreign securities—producing taxable income. This is because, if such income were taxable only to the grantor, and the grantor were a foreign grantor receiving foreign-source income, then no person would wind up being taxed in the U.S. on the trust's income.[24]

There are some important exceptions to the above rule prohibiting grantor trust status unless the person deemed to own the trust is a U.S. person or domestic corporation. The first exception is when an NRA funds the

trust and "the power to revest absolutely in the grantor title to the trust property to which such portion is attributable is exercisable solely by the grantor without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor."[25] In such a case, the NRA grantor will be deemed the owner of the trust income, and the trust will be treated as a grantor trust for U.S. income tax purposes. A related or subordinate party is presumed to be subservient to the grantor unless the presumption "is rebutted by a preponderance of the evidence."[26]

The power to revest, however, must be exercisable for at least 183 days during the taxable year of the trust.[27] If the first or last taxable year of the trust (including the year of the grantor's death) consists of fewer than 183 days, the grantor is treated as having a power to revest if the grantor has such power for each day of such first or last taxable year.[28] But if the trust fails to qualify for this exception in any particular year, it may not qualify in any subsequent year, even if the requirements otherwise would be satisfied.[29]

The second exception occurs when an NRA funds a trust and "the only amounts distributable from such portion (whether income or corpus) during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor."[30] In such a case the NRA will be treated as the owner of the trust income for U.S. income tax purposes. For purposes of Section 672, amounts distributable from a trust in discharge of a legal obligation of the grantor or the grantor's spouse that are enforceable under the local law of the jurisdiction in which the grantor or the grantor's spouse resides are treated as distributable to the grantor or the grantor's spouse.[31]

Section 672(f)(5) adds a further layer of protection against tax avoidance by preventing NRAs planning to adopt U.S. residency from circumventing the grantor trust rules. It provides that, if an NRA would be treated as the owner of any portion of a trust (without regard to the provisions of Section 672(f)), and the trust has a beneficiary who is a U.S. person, that beneficiary will be treated as the grantor of such portion to the extent that that beneficiary has made (directly or indirectly) transfers of property (other than a nongratuitous transfer or a gift that would be excluded from taxable gifts under Section 2503(b)) to such NRA. Thus, before the enactment of Section 672(f)(5), a wealthy NRA could avoid U.S. tax on his or her wealth by transferring property by gift to another NRA who could, in turn, contribute the property to a trust of which the initial NRA grantor was a discretionary income beneficiary and over which the intermediary NRA retained grantor powers over the trust. Upon becoming a U.S. resident, the former NRA could claim that he or she was not the grantor of the trust. Under Section 672(f), the former NRA will be deemed the grantor of the trust.

Certain trusts in existence on 19 September 1995 are not subject to Section 672(f): those treated as owned by the grantor under Section 676 (i.e., where a grantor has powers to revoke the trust and revest the trust assets) or Section 677 (i.e., where trust income is paid to or accumulated for the benefit of the grantor or the grantor's spouse[32]). Section 672(f) will apply, however, with regard to any portion of the trust attributable to transfers to the trust made after 19 September 1995.[33]

E. Tax on Contribution of Assets to a Foreign Trust

If a U.S. citizen or U.S. resident transfers property to a foreign trust, the transfer is treated as a sale or exchange of the transferred property for an amount equal to the fair market value of the property, and the transferor recognizes gain on the excess of the fair market value of the property over its adjusted basis.[34] Such a transfer essentially is taxed at the capital gains tax rates (which have ranged from fifteen to twenty-eight percent over the years). The tax on contribution to the foreign trust is not imposed, however, if the foreign trust is treated as a grantor trust for U.S. income tax purposes.[35] There would, however, still be IRS reporting requirements, discussed below.

III. Reporting Requirements for Contributions to and Distributions from a Foreign Trust and Receipts of Foreign Gifts

A. Overview

When a U.S. person makes a contribution to a foreign trust or receives a distribution from a foreign trust, in addition to complying with any required income tax reporting requirements and payments (discussed above), he or she is required to file a report with the IRS for the year of the contribution or distribution reporting the same.[36] Contributions by U.S. persons to foreign trusts and distributions to U.S. persons from foreign trusts must be reported annually on IRS Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. If a U.S. person is an owner of a foreign trust, IRS Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner, also must be filed.

It should be noted that "distributions from foreign trusts" also may include distributions that are constructively received, such as the payment of the beneficiary's debts by the trust, payments to the beneficiary in exchange for property or services of the beneficiary if the payments exceed the fair market value of the property or the value of the services, and direct or indirect loans received by the beneficiary from the trust, unless the loan is in exchange for a so-called "qualified obligation."[37]

IRS Form 3520 must be filed by a U.S. person for each year that he or she makes a contribution to or receives a distribution from a foreign trust. The form is due on the date the U.S. person's individual income tax return, IRS Form 1040, is due, including extensions, and must be filed

with the Internal Revenue Service Center, Philadelphia, PA 19255.[38]

With respect to contributions to a foreign trust, IRS Form 3520 requires the U.S. person who contributed the assets to report the name of the trust and the property contributed and value thereof. The U.S. person may also be required to report the names of the trustees or other persons in control of the trust and the names of the beneficiaries thereof and may be required to attached a copy of the trust documents and other agreements and letters of understanding that control the trust relationship.

Among other things, IRS Form 3520 requires the U.S. beneficiary of a foreign trust to report the name of the trust and its address, the amount of the distributions received from the trust during the tax year, whether any loans were received from the trust during the tax year—and, if so, whether the loan is a "qualified obligation"—and whether the beneficiary received a Foreign Grantor Trust Beneficiary Statement or Foreign Nongrantor Trust Beneficiary Statement from the trust (discussed below).

If adequate records are not provided to the IRS to determine the proper treatment of a distribution from a foreign trust, the U.S. beneficiary will be required to treat the distribution as an accumulation distribution (discussed above in Part II.C) includible in the income of the beneficiary. (This is so even if the trust is a grantor trust, the income of which is usually only taxable to the grantor with the distribution otherwise being treated as a gift, if adequate records are not provided to the IRS.[39]) The beneficiary will not be required to treat the entire distribution as an accumulation distribution if he or she receives from the foreign trust either a Foreign Grantor Trust Beneficiary Statement or a Foreign Nongrantor Trust Beneficiary Statement with respect to the distribution and attaches the statement to Form 3520[40] and if further inquiries by the IRS are answered to its satisfaction. If a Foreign Grantor Trust Beneficiary Statement is received from the trust, meaning that it is a grantor trust, the entire distribution to the U.S. beneficiary will be treated as a nontaxable gift. If a Foreign Nongrantor Trust Beneficiary Statement is received from the trust, meaning that the trust is not a grantor trust, the distribution will be taxed to the beneficiary under ordinary U.S. income tax rules (which may or may not result in accumulation distribution treatment, as discussed above in Part II.C).[41] If the U.S. beneficiary does not receive any such statement, he or she may be able to avoid treating the entire distribution as an accumulation distribution if he or she can provide certain information with respect to the distributions to the IRS (discussed below in Part III.B.3).

B. Foreign Grantor Trust: Reporting Requirements

1. Overview

As discussed above, under the grantor trust rules of Section 679, a U.S. person generally is treated as the owner of a foreign trust, and such trust is considered a foreign grantor trust, if (i) the U.S. person transfers property to the foreign trust, and (ii) the trust could benefit a U.S. person. In addition to the requirement under U.S. tax law that the income of a grantor trust be reported on the grantor's annual income tax return and taxed to the grantor, there are specific reporting requirements with which the trust and the grantor must comply with regard to such income.

Part II of IRS Form 3520 covers distributions to a U.S. person from a foreign grantor trust where the U.S. person is considered the owner of any of the assets of such trust. Part II, Line 20, asks the U.S. taxpayer who has received a distribution from a foreign grantor trust to provide the name, address, country of residence, and identification number (if any) of any other owners of the trust, as well as the relevant Code section causing that person to be considered an owner under the grantor trust rules. Certain other reporting requirements for such a U.S. taxpayer will depend on whether he or she receives from the trust a Foreign Grantor Trust Beneficiary Statement. Each case is discussed separately below in Part III.B.2 and 3. Whether or not a Foreign Grantor Trust Beneficiary Statement is received, however, the U.S. taxpayer will be asked to provide information regarding the appointment of a U.S. agent. This issue also is treated below.

2. If U.S. Taxpayer Receives Foreign Grantor Trust Beneficiary Statement

Part II, Line 22, of IRS Form 3520 asks whether the U.S. taxpayer has received a Foreign Grantor Trust Beneficiary Statement. If the taxpayer has received a Foreign Grantor Trust Beneficiary Statement, he or she must attach it to Form 3520 and enter from it the pertinent information regarding trust income and the nature and amount of distributions on Schedule B of Part III of IRS Form 3520.

The Foreign Grantor Trust Beneficiary Statement is found on page four of IRS Form 3520-A, which should be provided by the trustee to the taxpayer by March 15 of the year following the year at issue.[42] The statement must set forth the name and address of the trust, the name and address of the trustee, the name and address of the beneficiary, a description of the property distributed to the beneficiary, whether the owner of the trust is an individual, partnership, or corporation, and an explanation of the facts and law establishing that the foreign trust is treated as owned by another person, i.e., the grantor. In addition, the trustee must indicate whether the trust has appointed a U.S. agent who can provide the IRS with all relevant trust information (see below).

3. If U.S. Taxpayer Does Not Receive Foreign Grantor Trust Beneficiary Statement

As stated above, Part II, Line 22, of IRS Form 3520 asks whether the U.S. taxpayer has received a Foreign

Grantor Trust Beneficiary Statement. If the taxpayer has not received a Foreign Grantor Trust Beneficiary Statement, then Part II, Line 22, of IRS Form 3520 requires that the taxpayer, to the best of his or her ability, attach for the trust in question a "substitute" IRS Form 3520-A containing the information outlined in Part III.B.2 above, including information regarding the appointment of a U.S. agent. Provision by the taxpayer of the substitute IRS Form 3520-A, however, does not relieve the taxpayer of penalties (discussed below in Part III.F.1) for failure to cause the trust to file the form.[43] In addition to the substitute IRS Form 3520-A, the taxpayer is required to file with his or her tax return IRS Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request, to inform the IRS that the owner has not received a Foreign Grantor Trust Owner Statement.[44]

C. Foreign Nongrantor Trust: Reporting Requirements

If a foreign trust does not fall within the definition of a foreign grantor trust under Section 679, it is deemed a foreign nongrantor trust for U.S. tax purposes. Under U.S. tax law, distributions by a foreign nongrantor trust to a U.S. beneficiary are taxed to such beneficiary.

1. If U.S. Taxpayer Receives Foreign Nongrantor Trust Beneficiary Statement

Part III of Form 3520 covers distributions to a U.S. person from a foreign trust. Part III, Line 30, asks whether the taxpayer has received a Foreign Nongrantor Trust Beneficiary Statement with respect to any such distribution. If the taxpayer has received a Foreign Nongrantor Trust Beneficiary Statement, he or she must attach it to Form 3520 and enter the pertinent information on Schedule B of IRS Form 3520.[45]

The Foreign Nongrantor Trust Beneficiary Statement is not part of a return and must, therefore, be prepared independently by the trustee. Pursuant to IRS Notice 97-34 and the Instructions for IRS Form 3520, a Foreign Nongrantor Trust Beneficiary Statement should contain the following information:

- Foreign Trust Background Information, including:
  - the name, address, and Employer Identification Number (EIN) (if available) of the trust;
  - the name, address, and Taxpayer Identification Number (TIN) (if applicable) of the trustee furnishing the statement;
  - the method of accounting used by the trust (cash or accrual);
  - the taxable year to which the statement applies; and
  - a statement identifying whether any of the grantors are partnerships or corporations.
- U.S. Beneficiary Information, including:
  - the name, address, and TIN of the U.S. beneficiary; and
  - a description of the property (including cash) distributed or deemed distributed to the U.S. person, and the fair market value of said distribution.
- Sufficient information to enable the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes. According to IRS Notice 97-34, information similar to that presented in an IRS Form K-1 would be sufficient. The trustee has the opportunity here to report what the components of the distribution represent (e.g., interest, dividends, etc.), so that the beneficiary can report the proper information on the beneficiary's own tax return. Income, deductions, etc., need to be reported using U.S. tax concepts, which may require significant recharacterization of amounts shown on the financials of the foreign trust.
- A statement that, upon request, the trust will permit either the IRS or the beneficiary to inspect and copy the trust's permanent books of account, records, and such other documents that are necessary to establish the appropriate treatment of any distribution. This statement is not necessary if the trust has appointed a U.S. agent.[46]
- The name, address, and EIN of the trust's U.S. agent, if applicable.

2. If U.S. Taxpayer Does Not Receive Foreign Nongrantor Trust Beneficiary Statement

Part III, Line 30, of IRS Form 3520 also provides for the case in which the taxpayer does not receive a Foreign Nongrantor Trust Beneficiary Statement from a foreign trust with respect to distributions received. In such a case, the taxpayer is asked to complete Schedule A of Part III of Form 3520. This schedule requires only that the taxpayer inform the IRS of the amounts received from the foreign trust and the number of years the trust has been a foreign trust. The taxpayer is not asked on this schedule to provide identifying information with regard to the trust in question or to its trustee.

The disadvantage to the taxpayer of not procuring a Foreign Nongrantor Trust Beneficiary Statement is that the IRS, pursuant to IRS Notice 97-34, may deem (unless a U.S. agent is appointed[47]) the entire distribution made by any foreign nongrantor trust an accumulation distribution, which would subject the amount of the distribution to unfavorable tax treatment and the imposition of the interest charge under the throwback rules (see Part II.C above). If a U.S. beneficiary cannot obtain a Foreign Nongrantor Trust Beneficiary Statement, however,

Schedule A of Part III of Form 3520 allows the U.S. beneficiary to avoid treating the entire amount as an accumulation distribution if the U.S. beneficiary can provide certain information regarding actual distributions from the trust for the prior three years. Under this "default treatment," the U.S. beneficiary is allowed to treat a portion of the distribution as a distribution of current income based on the average of distributions from the prior three years, with only the excess amount of the distribution treated as an accumulation distribution. In making the calculation, the prior three years' distributions are added together. The total is then multiplied by a factor of 1.25. This amount is then divided by 3, with only the excess amount of the distribution treated as an accumulation distribution. This formula in effect assumes that current income increases by twenty-five percent each year before the excess is treated as an accumulation distribution.

The information needed in order to qualify for default treatment is as follows:

- the number of years the trust has been a foreign trust (with any portion of a year to be considered a complete year[48]);
- the total distributions received from the foreign trust during the current year, including loans from a "related foreign trust" (a "related foreign trust" is a trust of which the U.S. taxpayer is a grantor or beneficiary of which a "related person" is a grantor or beneficiary; a "related person" is (i) a sibling of the whole or half blood, an ancestor, a lineal descendant, or a spouse of the U.S. taxpayer or of any related person or (ii) a corporation of which the U.S. taxpayer owns directly or indirectly more than fifty percent in value of the outstanding stock); and
- the total distributions received from the foreign trust during the preceding three years.[49]

3. Reporting of Accumulation Distributions under the Throwback Rules

Once the amount of an accumulation distribution is determined on Schedule A or B of Part III of IRS Form 3520, the throwback tax on the accumulation distribution must be calculated using IRS Form 4970, Tax on Accumulation Distribution of Trusts. As discussed above, the tax is determined by averaging the distributions over a number of years equal to that over which the income was earned and by including a fraction of the income received from the trust in the beneficiary's income for each of the five preceding years, excluding the years with the highest taxable income and the lowest taxable income. The fraction of income included in the five years is based on the number of years the income was accumulated.[50] The interest surcharge imposed on the throwback tax is entered on Line 52 of Schedule C of Part III of IRS Form 3520.

D. Appointment of U.S. Agent

Any foreign trust (grantor or nongrantor) may appoint a limited agent (a "U.S. Agent") for purposes of responding to (i) IRS requests to examine records or produce testimony with respect to any items included on IRS Form 3520 or 3520-A or (ii) an IRS summons regarding such records or testimony. A U.S. Agent is a U.S. person (including a U.S. grantor, a U.S. beneficiary, or a domestic corporation controlled by the grantor) having a binding contract with a foreign trust that allows such person to act as the trust's authorized U.S. agent for the purposes mentioned above.[51] The format of the contract is contained in the IRS Form 3520-A Instructions.[52]

If a foreign *grantor* trust does not choose to appoint a U.S. agent, then the IRS can determine unilaterally the amounts to be included in income by the owner of the foreign trust.[53] Also, if no agent is appointed, various attachments must be filed along with IRS Form 3520-A, including (i) a summary of the terms of the trust and all written and oral agreements and understandings with the trustee that are related to the trust (whether or not legally enforceable) and (ii) copies of all trust documents, including the trust agreement and amendments, memoranda or letters of wishes, and the like.[54]

If the U.S. agent of a foreign grantor trust resigns or liquidates, or the U.S. agent's responsibility as an agent of the foreign grantor trust is terminated, the U.S. owner of the foreign trust must ensure that the foreign trust notifies the Commissioner of Internal Revenue within ninety days of such event by filing an amended IRS Form 3520-A.[55] This notification must contain the name, address and TIN of the new U.S. agent (if any).[56]

If a foreign *nongrantor* trust does not choose to appoint a U.S. agent, then the IRS can determine unilaterally the amounts to be included in income by the beneficiary of the foreign trust, unless "adequate records" are provided to the IRS.[57] Presumably this means that it would be enough to complete Schedule A of Part III of Form 3520 as outlined in Part III.C.2 above.

Even if a U.S. agent of a foreign trust—be it nongrantor or grantor—is identified on IRS Form 3520 or 3520-A, the U.S. beneficiary or owner of the foreign trust may be treated as providing incorrect information and thus may be subject to the penalty described in Section 6677 (see Part III.F.1 below) if either the U.S. agent or the foreign trust does not comply with its obligations under the agency agreement (e.g., if the foreign trust fails to produce records requested by the IRS in reliance on the bank secrecy laws of the country where the trust's bank accounts are located).[58] This is the case even if the U.S. beneficiary has attached to the IRS Form 3520 a Foreign Grantor Trust Beneficiary Statement or a Foreign Nongrantor Trust Beneficiary Statement.[59]

E. Receipts of Foreign Gifts

If the value of the aggregate "foreign gifts" received by a U.S. citizen or resident during any taxable year exceeds ten thousand dollars, the recipient must provide such information as the IRS prescribes.[60] The term "foreign gift" is any amount received from a person other than a U.S. citizen or resident that the recipient treats as a gift or bequest.[61]

A U.S. citizen or resident is required to report the receipt of a foreign gift only if the aggregate amount of gifts from a particular foreign person or estate exceeds one hundred thousand dollars during the taxable year and is required to report the receipt of a gift from a foreign corporation or partnership if the aggregate amount of gifts from all such entities exceeds ten thousand dollars during the taxable year.[62] For purposes of determining these thresholds, the gifts from related persons are aggregated.[63]

Note that gifts made by foreign persons (whether to U.S. persons or non-U.S. persons) are not subject to the U.S. gift tax, unless the gift is of U.S.-situs real or tangible property.[64] Nevertheless, the gifts may be reportable if received by a U.S. person under the above rules.

Foreign gifts are reported on IRS Form 3520, which is the same form used for reporting transactions with foreign trusts.

F. Penalties

1. IRS Forms 3520 and 3520-A

Significant penalties are associated with the failure to file a complete and accurate IRS Form 3520 or Form 3520-A. Under Section 6677(a), penalties are imposed for:

- failure to file in a timely manner;
- failure to include all the information requested; or
- failure to include accurate information.

For failure to file IRS Form 3520 to report a transaction with a foreign trust, Section 6677(a) imposes a penalty of thirty-five percent of the gross reportable amount (as defined in Section 6677(c))—i.e., thirty-five percent of the gross value of the property transferred to the foreign trust or thirty-five percent of the distribution(s) made from the foreign trust. The penalty is imposed on the individual who was required to file the IRS Form 3520.

The penalty for failure to file IRS Form 3520-A will be imposed directly on the U.S. owner of the foreign trust. The penalty is equal to five percent of the value of the trust assets treated as owned by the U.S. person.[65]

If failure to comply with the reporting requirements continues, the IRS is authorized to impose additional penalties of up to ten thousand dollars for each thirty-day period during which the failure continues after the IRS mails a notice of failure to comply with the required reporting, not to exceed the value of the gross reportable amount.[66]

Section 6039F imposes a penalty of five percent of the amount of a foreign gift received by a U.S. person which was required to be reported on IRS Form 3520. This five percent is imposed monthly until the amount is reported, not to exceed twenty-five percent of the foreign gift. The penalty is imposed on the recipient of the gift, and not the donor.

Both Section 6677 and Section 6039F make an exception from the imposition of penalties if it can be shown that the failure to file was due to "reasonable cause and not due to willful neglect."[67] The Internal Revenue Manual states that reasonable cause "is generally granted when the taxpayer exercises ordinary business care and prudence in determining their tax obligations but nevertheless is unable to comply with those obligations."[68] Some factors that the IRS may consider in determining whether the taxpayer exercised ordinary business care and prudence include: the taxpayer's reason and whether it corresponds to the events on which penalties are assessed; whether the taxpayer's compliance history shows a pattern of noncompliance or if this is a first-time failure; the length of time between the noncompliance and when the taxpayer subsequently complied with the reporting requirements; and whether there were circumstances beyond the taxpayer's control.[69]

Some practitioners have found that the IRS has shown considerable leniency in abating penalties.[70] In particular, the IRS has been sympathetic where the failure has occurred in the first year in which a formerly non-U.S. taxpayer became a U.S. resident or where the taxpayer complied as soon as possible after finding out about the requirement.[71]

Initially, the IRS generated automatic notices imposing penalties amounting to millions of dollars for late-filed IRS Forms 3520 and 3520-A.[72] This prompted taxpayers to scramble to have those penalties abated. Now, rather than imposing the penalty automatically, the IRS has been generating notices to taxpayers asking for an explanation for the late filing.[73]

Section 6677(d) states that reasonable cause for the failure to comply does not exist merely because a foreign country would impose a civil or criminal penalty for disclosing the information required to be reported on the forms. Furthermore, refusal on the part of a foreign trustee to provide information needed to meet the reporting requirements, whether due to difficulty in producing the required information or because provisions in the trust instrument prevent disclosure of required information (e.g., in the case of a blind trust), will not be considered reasonable cause.[74]

The penalties under Section 6677 apply only to the extent that the transaction is not reported or is not reported accurately. For example, if a U.S. person receives a distribution from a foreign trust of one million dollars but only reports four hundred thousand dollars of the amount received, the penalties may be imposed only on the amount that was unreported: in this case, six hundred thousand dollars.[75]

2. IRS Form 8082

Failure to file IRS Form 8082 may subject the taxpayer to the accuracy-related penalty under Section 6662 or the fraud penalty under Section 6663.[76] Section 6662 imposes a single accuracy-related penalty equal to twenty percent of the portion of underpayment of tax attributable to, inter alia, (i) negligence or disregard of rules and regulations or (ii) any substantial underpayment of tax. An underpayment of tax is considered "substantial" if the understatement exceeds the greater of ten percent of the tax required to be shown on the return or five thousand dollars.[77]

Under Section 6663, if any part of any underpayment of tax required to be shown on a return is due to fraud, a penalty is assessed in an amount equal to seventy-five percent of the portion of the underpayment attributable to the fraud. The initial burden of proving fraud on the part of the taxpayer rests with the IRS.[78] Proof of fraud requires a showing that the taxpayer engaged in intentional wrongdoing with the specific intent to avoid a tax known or believed to be owed.[79]

IV. Reporting Requirements for Foreign Accounts in Which a U.S. Person Has a Financial Interest or Over Which a U.S. Person Has Signature Authority

A. Form TD F 90-22.1: Overview

U.S. persons must file Form TD F 90-22.1 to report all foreign bank accounts and foreign financial accounts in which they have a financial interest or over which they have signatory or other authority, if the aggregate value of these accounts is more than ten thousand dollars.[80] Form TD F 90-22.1 is filed with the U.S. Department of the Treasury for each year in which the U.S. person has any such interest in or authority over any such accounts.[81]

A "financial account" includes "any bank, securities, securities derivatives or other financial instruments accounts.… The term also means any savings, demand, checking, deposit, time deposit, or any other account… maintained with a financial institution or other person engaged in the business of a financial institution."[82]

A U.S. person has a "financial interest" in a foreign financial account for which the owner of record or holder of legal title is, *inter alia*, (i) a trust in which the U.S. person "either has a present beneficial interest, either directly or indirectly, in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income"[83] or (ii) "a corporation in which the U.S. person owns directly or indirectly more than 50 percent of the total value of shares of stock or more than 50 percent of the voting power for all shares of stock."[84]

For each reportable foreign financial account, the following information must be supplied on the Form TD F 90-22.1:

- the maximum value of the account during the calendar year in question;
- the type of account (bank, securities, etc.);
- the name of the financial institution in which the account is held;
- the account number or other designation; and
- the mailing address of the financial institution in which the account is held.

A U.S. person with a financial interest in over twenty-five foreign bank accounts, however, need only indicate this fact on the Form TD F 90-22.1 and need not list the information for all the accounts, as long as information for the accounts is made available to the Treasury Department upon request.[85]

B. Form TD F 90-22.1: Due Date and Penalties

Form TD F 90-22.1 is due on or before June 30 of the year following the year in which the U.S. person possessed the signatory power over or financial interest in the foreign account. The penalty for failure to file this form, if due to a willful violation, is the greater of one hundred thousand dollars or fifty percent of the balance in the account at the time of the violation in the case of failure to report the existence of the account or any identifying information.[86]

If a U.S. person learns that he or she was required to file Forms TD F 90-22.1 for earlier years, the U.S. person should file the delinquent Forms TD F 90-22.1 and attach a statement explaining why the reports are being filed late.[87] No penalty will be asserted if the IRS determines that the late filings were due to reasonable cause (discussed above in Part III.F.1).[88] Beginning 22 October 2004, nonwillful violations without reasonable cause may result in a penalty of up to ten thousand dollars.[89]

Note that the form is filed, not with the IRS, but rather with the U.S. Department of the Treasury, P.O. Box 32621, Detroit, MI 48232-0621.[90] The due date of the form is not tied to the filer's income tax return (e.g., Form 1040), and there is no extension of time available for filing the form.

According to the IRS website,[91] if there is insufficient information available to file the form by the due date, the form should be filed with such information as is available,

and an amended form should be filed later when information becomes available.

V. IRS Circular 230 Disclosure

To ensure compliance with requirements imposed by the IRS, the authors inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

Endnotes

1. I.R.C. § 7701(a)(30)(E); Treas. Reg. § 301.7701-7(a)(1). Except where otherwise indicated, all references in this paper to the "Internal Revenue Code," the "Code," and the "I.R.C." shall be construed to mean the U.S. Internal Revenue Code of 1986, and all references to "Section" shall be construed to mean the relevant section of the Code. Furthermore, except where otherwise indicated, all references in this memorandum to the "Treasury Regulations," the "Regulations," and "Treas. Reg." shall be construed to mean the pertinent regulations promulgated by the U.S. Secretary of the Treasury.
2. I.R.C. § 7701(a)(31)(B).
3. I.R.C. § 671.
4. IRS Notice 97-34, 1997-1 C.B. 422, Section III.A.
5. I.R.C. § 679(a)(4).
6. I.R.C. § 679(c)(1), (d).
7. I.R.C. § 679(c)(3).
8. Treas. Reg. §§ 1.679-1(c)(5), 1.679-3(f)(1).
9. I.R.C. § 643(a)(6).
10. I.R.C. § 651(a); Treas. Reg. § 1.651(a)-1.
11. I.R.C. §§ 651(a), 652.
12. I.R.C §§ 651(b), 652(a).
13. I.R.C. § 661(a); Treas. Reg. § 1.661(a)-2.
14. I.R.C. § 661(a).
15. I.R.C. § 662(a).
16. I.R.C. § 662(a)(2).
17. I.R.C. §§ 662(a)(2), 665–668.
18. I.R.C. § 667(a).
19. I.R.C. § 665(b).
20. I.R.C. § 667(b)(1); *see* IRS Form 4970 (2008) and Instructions.
21. I.R.C. §§ 667(a)(3), 668(a), 6621(a).
22. I.R.C. § 672(f)(1).
23. *Id.*
24. *See, e.g.*, Rev. Rul. 69-70, 1969-1 C.B. 182.
25. I.R.C. § 672(f)(2)(A)(i).
26. Treas. Reg. § 1.672(f)-3(a)(1).
27. Treas. Reg. § 1.672(f)-3(a)(2).
28. *Id.*
29. Treas. Reg. § 1.672(f)-3(a)(1).
30. I.R.C. § 672(f)(2)(A)(ii).
31. Treas. Reg. § 1.672(f)-3(b)(2)(i).
32. Not including, however, those treated as owned by the grantor under I.R.C. § 677(a)(3) because of the application of trust income to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse. Treas. Reg. § 1.672(f)-3(d).
33. *Id.*
34. I.R.C. § 684(a).
35. I.R.C. § 684(b)(1).
36. I.R.C. § 6048(a), (c).
37. IRS Notice 97-34, 1997-1 C.B. 422, Section V; I.R.C. § 643(i); Treas. Reg. § 1.643(h)-1.
38. Note that this may be a different address from that at which the beneficiary files his or her U.S. income tax return.
39. I.R.C. § 6048(c)(2).
40. IRS Notice 97-34, 1997-1 C.B. 422, Section V.B.
41. *Id.*
42. The trustee should file IRS Form 3520-A with the Internal Revenue Service Center, P.O. Box 409101, Ogden, UT 84409, by the same date.
43. *See* IRS Form 3520 Instructions (2009) (Line 22).
44. *See* IRS Form 3520 Instructions (Line 23). Filing IRS Form 8082 does not relieve the taxpayer of penalties for failure to cause the trust to file IRS Form 3520-A. *See id.*
45. The information may be entered instead on Schedule A of IRS Form 3520, but generally it is more beneficial to complete Schedule B, which calculates the portion of the distribution that should be treated as current or accumulated income based on actual facts. To complete Schedule B, the trustee must characterize the income on the Foreign Nongrantor Trust Beneficiary Statement so as to distinguish between ordinary income, accumulation distribution, capital gains, and distribution of corpus.
46. IRS Form 3520 Instructions (Line 30).
47. *See* I.R.C. § 6048(c)(2)(A) and Part III.D below.
48. IRS Form 3520 Instructions (Line 32).
49. IRS Form 3520 Part III and Instructions.
50. I.R.C. § 667(b)(1); *see* IRS Form 4970 (2010) and Instructions.
51. *See* IRS Form 3520-A Instructions (2009), "U.S. Agent," p. 2.
52. *See also* IRS Notice 97-34, 1997-1 C.B. 422, Section IV.B.
53. *See* I.R.C. § 6048(b)(2)(A).
54. *See* IRS Form 3520-A Instructions (Line 2); Section 6048(b)(1)(A).
55. *See* IRS Notice 97-34, 1997-1 C.B. 422, Section IV.B. IRS Notice 97-34 does not mention IRS Form 3520 in this context. On one hand, as IRS Form 3520-A only applies to foreign grantor trusts, as IRS Notice 97-34 was issued prior to revision of IRS Form 3520, and as information on the U.S. agent is requested on Line 3 of IRS Form 3520, one could argue that an amended IRS Form 3520 should be filed in the case of a change of U.S. agent for a foreign nongrantor trust. On the other hand, it also seems reasonable to assume that the IRS would place a heavier informational burden on an owner-beneficiary than on a nonowner-beneficiary.
56. *Id.*
57. *See* I.R.C. § 6048(c)(2)(A).
58. *See* IRS Notice 97-34, 1997-1 C.B. 422, Section IV.B; IRS Form 3520 Instructions (Lines 29 and 30). The appointment of a U.S. agent in and of itself should have no effect on the trust's U.S. tax liabilities: under Section 6048(b), a foreign trust appointing a U.S. agent will not be considered to have an office or a permanent establishment in the United States, or to be engaged in a trade or business in the United States, solely because of the activities of such agent. Furthermore, the appointment of a U.S. agent will not subject such agent or records to legal process for any purpose other than

determining the correct tax treatment of distributions. *See* I.R.C. § 6048(b).

59. *See* IRS Form 3520 Instructions (Lines 29 and 30).
60. I.R.C. § 6039F(a); Notice 97-34, 1997-1 C.B. 422, Section VI.
61. I.R.C. § 6039F(b); Notice 97-34, 1997-1 C.B. 422, Section VI.
62. Notice 97-34, 1997-1 C.B. 422, Section VI.B.1 and 2.
63. *Id*. at Section VI.B.3; see I.R.C. § 643(i)(2)(B) for aggregation rules.
64. I.R.C. §§ 2501(a)(2) and 2511(a).
65. I.R.C. § 6677(b).
66. *See* I.R.C. § 6677(a).
67. I.R.C. §§ 6677(d), 6039F(c)(2).
68. Internal Revenue Manual 20.1.1.3.1(2).
69. Internal Revenue Manual 20.1.1.3.1.2(2)(A) through (D).
70. *See, e.g.*, Evelyn M. Capassakis, Reporting International Trust and Gift Transactions and Penalties for Failure to Report, Fourth International Estate Planning Institute (27 May 2008).
71. *Id.*
72. *Id.*
73. *Id.*
74. IRS Notice 97-34, 1997-1 C.B. 422, Section VII.
75. *Id.*
76. IRS Form 8082 Instructions, "Penalties."
77. I.R.C. § 6662(d)(1).
78. *See* I.R.C. § 7454(a).
79. *See Stoltzfus v. U.S.*, 398 F.2d 1002 (3d Cir. 1968).
80. Title 31. If such is the case, U.S. persons also must answer in the affirmative the question on Form 1040, Schedule B, about their ownership or signatory authority over a foreign account.
81. The authority to prescribe such reporting is granted to the Secretary of Treasury under 31 U.S. Code ("U.S.C.") § 5314.
82. Form TD F 90-22.1 (2008), General Instructions at 6.
83. *Id.*
84. *Id.* Based on the variety of interests that constitute a "financial interest," it is quite possible that multiple people may have a financial interest in the same foreign account. In such a case, each person who has such a financial interest in the account must file Form TD F 90-22.1. *Id.*
85. 31 Code of Federal Regulations § 103.24; Form TD F 90-22.1, General Instructions at 7 (Item 14).
86. 31 U.S.C. § 5321(a)(5). There is an exception if (i) the violation was due to reasonable cause, and (ii) the amount of the transaction or the balance in the account at the time of the transaction was properly reported. *Id.*; see also 31 U.S.C. § 5322 for criminal penalties.
87. IRS News Release IR-2008-79 (17 June 2008).
88. *Id.*
89. 31 U.S.C. § 5321(a)(5)(A), (B)(i).
90. The delivery address for private courier services is: IRS Enterprise Computing Center, ATTN: CTR Operations Mailroom, 4th Floor, 985 Michigan Avenue, Detroit, MI 48226. FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements, http://www.irs.gov/businesses/small/article/0,,id=210244,00.html (last visited 3 Jan. 2011) (Question 13).
91. FAQs regarding Report of Foreign Bank and Financial Accounts (FBAR)—Filing Requirements, http://www.irs.gov/businesses/small/article/0,,id=210244,00.html (last visited 3 Jan. 2011) (Question 9).

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Anti-Tax-Avoidance Regimes in New Zealand

By John W. Hart

I. Introduction

The purpose of this paper is to briefly survey a number of the anti-tax-avoidance regimes included within the New Zealand Income Tax Act 2007 (the "Act"). I should emphasize that there are a number of specific regimes which I do not address, such as transfer pricing and thin capitalization, as well as quite a few other very specific provisions scattered throughout the Act.

The main focus of the paper will be an overview of the general anti-avoidance regime and the trust taxation regime.

All Subpart references are to the Act.

II. Financial Arrangement Rules (Subpart EW)

These extremely complex rules have been part of New Zealand's legislative framework since 1986. As New Zealand does not have a comprehensive capital gains tax, there was a concern that financial arrangements (which are defined very broadly to encompass loans, other debt instruments, derivatives, and a myriad of other similar products) were being deliberately designed with a view to producing capital rather than revenue gains for holders of such instruments.

In addition, a number of relatively conventional instruments were taxed recognizing the revenue/capital distinction—a simple example being a debt instrument such as government stock bearing a fixed coupon rate of instrument. If the coupon rate of interest were to drop on newer issues of government stock, the consequence would be that the older, higher-yielding stock could be sold for a sum greater than its face value. Under conventional analysis this gain was considered to be on capital account (unless the recipient was in the business of trading in such instruments), and was therefore tax-free.

The financial arrangement rules (previously called the "Accrual Rules") were designed to compel all such gains to be treated as being on revenue account, and to be spread on a "yield-to-maturity" basis over the life of the financial instrument.

Similarly, expenses incurred with respect to such instruments would be spread on a yield-to-maturity basis in order to defeat the structures that were designed to create an accelerated tax deduction for the payer and a deferred recognition of the income for the payee.

The financial arrangement rules were introduced shortly before the controlled foreign company, foreign investment fund, and trust taxation regimes were enacted, and were part of a tax reform initiative emanating from the New Zealand Government Treasury. This was in large part a response to the removal of exchange controls in New Zealand in 1985, which threw open the door to tax planning and structuring that had hitherto not been possible.

The financial arrangement rules are, however, somewhat one-sided, in that in some circumstances one can end up with an asymmetrical outcome. This is because losses on a financial arrangement will not generally be deductible unless the party making the losses is in the business of dealing or investing in such instruments. In other words, any party deriving a gain under a financial arrangement would be taxed even if it was a one-off transaction, whereas to claim a deduction the party making the loss generally would have to be carrying on a business.

The financial arrangement rules apply to foreign exchange gains and losses as well, which can cause difficulties. For example, recent migrants to New Zealand who are holding off converting foreign funds to New Zealand currency—until the New Zealand dollar weakens against that foreign currency—will suffer the consequence that if and when that shift does occur there is a notional (but taxable) foreign exchange gain determined by reference to the value of the foreign currency at the time the individual acquired New Zealand tax residency.

There are certain de minimis exemptions from the financial arrangement rules. Also, the rules only apply to New Zealand resident holders/issuers of financial arrangements.

III. Controlled Foreign Company (CFC) Regime (Subparts CQ and EX)

The broad effect of this regime is to capture within the New Zealand tax net any income derived by a foreign company that is controlled by five or fewer New Zealand residents. The income (and losses, if applicable) derived or suffered by such a company is attributed to any New Zealand resident taxpayer holding an income interest of ten percent or more in the controlled foreign company ("CFC").

The tax is assessed as if the company were a foreign branch of a New Zealand company, but the assessment is against the shareholder. This "branch equivalent income" or "branch equivalent loss" is then attributed to the resident taxpayers in accordance with their respective income interests in the CFC. Losses are "ring-fenced" by being restricted to deduction from gross income derived from the same country as the country of residence of the CFC generating the loss.

There was an exemption for companies resident in a "grey list" country. The grey list previously comprised Australia, Canada, Germany, Japan, Norway, Spain, the United Kingdom, and the United States. The grey list has been dramatically reduced to only Australian-resident CFCs as a result of the introduction of the "active business income exemption," which took effect on 1 April 2010. Under this new regime only passive income of CFCs (such as certain interest and dividend payments, royalties, and some rent) will be attributed to New Zealand-resident CFC shareholders on a so-called "branch equivalent" basis.

The CFC rules contain a number of exemptions and qualifications. In particular, no attribution of passive CFC income is required if the CFC's gross passive income is less than five percent of its total gross income.

For New Zealand companies with foreign subsidiaries, the changes to the CFC regime are highly advantageous. Foreign subsidiary income will be taxed when repatriated and ultimately distributed to noncorporate shareholders. The dividends will be tax-free when received by the New Zealand corporate parent.

Whilst this is a significant improvement on the previous regime and provides a potentially long-term tax deferral, it does not remedy the double-tax outcome that can arise in this scenario due to the fact that the ultimate natural person (or trust) shareholders will generally not receive a credit for underlying foreign corporate tax paid when receiving dividend payments.

IV. Foreign Investment Fund (FIF) Regime (Subparts CQ and EX)

A foreign investment fund ("FIF") is any interest held in a foreign entity, with an exemption for the following: interests subject to the CFC regime; employer-sponsored superannuation arrangements; and interests that are held by individuals and whose cost does not exceed NZD $50,000.

There are four methods for calculating foreign investment fund income or loss:

- the "comparative value" method (which is the default method), capturing movement in value over the income year;
- the "deemed rate of return" method, involving application of a prescribed rate of return to the book value of the FIF interest;
- the "accounting profits" method, which is the investor's proportionate share based upon shareholding of the net after-tax accounting profits of the FIF; and
- the "branch equivalent" method, which involves ascertaining the income of the FIF by the use of New Zealand tax rules.

The Income Tax Act 2004 was amended with effect from 1 April 2007 to provide new rules for taxing offshore portfolio investment in shares, and these changes have been carried forward into the Act. The new rules generally apply to an investment by a New Zealand resident in a foreign company (or unit trust) when the investor owns less than ten percent of the company.

The main changes are that the "grey list" exemption from the foreign investment fund rules has been removed, and a new "fair dividend rate" method—which broadly taxes five percent of a portfolio's opening value each year—generally applies to interests of less than ten percent in foreign companies. If the total return on the share portfolio is less than five percent, then individuals and family trusts pay tax on the lower amount (they pay no tax if the shares make a loss).

Under the new rules, investments in Australian-resident companies listed on an approved index of the Australian Stock Exchange are taxed the same as New Zealand investments: They are taxable on dividends if the investment is held on capital account, or on dividends and realized gains if held on revenue account.

V. The New Zealand Trust Taxation Regime (Subpart HC)

A. Introduction

A new trust taxation regime was introduced in New Zealand on 1 April 1988. One of the main aims of the new regime was to counter the tax-deferral and -avoidance benefits obtained by New Zealand residents who utilized trusts established in low-tax jurisdictions.

However, a by-product of the regime is that a trust with New Zealand-resident trustees, but settled by a nonresident settlor, is not subject to tax in New Zealand except on income which has its source in New Zealand. This is the case even if all the trustees of the trust are New Zealand tax residents, with the consequence that the trust itself would be regarded as a New Zealand tax resident.

In this way, a New Zealand "foreign" trust can operate as an "offshore" trust.

B. New Zealand Trust Taxation Regime

1. Overview

This regime is sometimes known as the "settlor trust" regime because the tax treatment of the trust turns upon the tax residency of the settlor.

A "settlor" is defined very broadly and includes anyone who provides goods or services to a trust for less than full market value or acquires goods or services from a trust for greater than market value. There are extensive provisions designed to catch indirect settlements through nominees and other means. Consequently to preserve a trust's foreign trust status (so that it operates as an off-

shore trust) it is crucial that no inadvertent settlements be made upon the trust by a New Zealand tax resident.

The regime identifies three types of trusts for taxation purposes:

- complying trusts
- foreign trusts
- non-complying trusts

The tests which determine whether a particular trust constitutes a complying, foreign, or non-complying trust are applied at each time a distribution is made to a beneficiary, whether it is a distribution of current year income or from accumulated income or capital gains.

2. Complying Trust

A trust will constitute a complying trust where all the trustees' New Zealand income tax liabilities have been satisfied, and at the time at which a distribution is made to a beneficiary either:

- No amount of trustee income was nonresident passive income (e.g., dividends, interest, royalties) subject only to nonresident withholding tax (NRWT)—for example if the trust had only a foreign settlor and a foreign trustee; or
- There is no exempt income under section CW 54 (foreign-source amounts derived by trustees), which is an exclusion for non-New Zealand-source income derived by a New Zealand resident trustee with respect to a trust with no New Zealand-resident settlor.

In general terms, a complying trust is an ordinary, domestic New Zealand trust with New Zealand resident trustees and a New Zealand resident settlor.

Except to the extent that distributions from a complying trust constitute current year beneficiary income, distributions will not be assessable to beneficiaries. As New Zealand does not have a capital gains tax, capital gains can be passed through to beneficiaries tax-free. Accumulated income which has been taxed in the trustees' hands can be passed to the beneficiaries with no further tax liability.

3. Foreign Trust

A trust will constitute a foreign trust if, from the later of 17 December 1987 or the date on which a settlement was first made on the trust until the date on which a distribution is made, no settlor of the trust has been a New Zealand tax resident. This is the case even if there are New Zealand-resident trustees or beneficiaries.

4. Non-Complying Trust

A trust will constitute a non-complying trust where, at the time a distribution is made, it is neither a complying trust nor a foreign trust. Generally this will include the following:

- A trust which would otherwise be a complying trust which has not satisfied all of its obligations under the Income Tax Act; or
- An "offshore" trust on which a settlement has been made by a person who has been a tax resident of New Zealand after the later of 17 December 1987 or the date on which a settlement was first made on the trust.

Non-complying trusts are deemed to be liable to New Zealand taxation on worldwide income, and the New Zealand-resident settlors are liable to pay New Zealand tax on all the trust's income, as agents of the trustees.

This is the anti-avoidance element for New Zealand settlors of an offshore trust. Ironically, if the settlor complies with this agency liability (it is an offense not to), the trust will then meet the criteria for a complying trust, i.e., tax will have been paid on the trust's worldwide income since inception.

C. Taxation of Distributions

The primary significance arising from the different types of trusts relates to the taxation of distributions made by the trusts. As noted above, with respect to a complying trust, beneficiary income (which means income paid or applied during, or within twelve months after the end of, the income year in which the income is derived) is taxed in the beneficiary's hands, but otherwise the beneficiary is not liable for tax on any amount received from the trust.

By contrast, a distribution from a foreign trust to a New Zealand-resident beneficiary will constitute a taxable distribution unless it represents a distribution of realized capital gains or of the corpus of the trust. The tax exemption for capital gains does not apply to gains derived from transactions with associated persons. The definition of "associated persons" is contained in the Act and is cast broadly.[1]

Crucially, a non–New Zealand-resident beneficiary will not be subject to New Zealand tax with respect to any distributions from a foreign trust unless the income has its source in New Zealand. Similarly, the trustees of a foreign trust will not be subject to tax in New Zealand except on income earned in New Zealand.

Non-complying trusts are subject to a penal tax regime, with the consequence that all distributions (other than of corpus) to New Zealand beneficiaries are subject to full New Zealand tax. In the case of distributions of accumulated income (falling outside the definition of beneficiary income) and capital gains, the tax rate is forty-five percent. By contrast the usual New Zealand tax rates for individuals commence at 10.5% and increase progressively to a top rate of 33%.

The concept of a "taxable distribution" for both foreign and non-complying trusts includes the use of trust assets for no consideration, or for below-market consideration. By contrast, assets of a complying trust can be enjoyed by beneficiaries without triggering a deemed taxable distribution.

D. The Advantages of a New Zealand Foreign Trust

The Income Tax Act does not expressly deem a foreign trust to be a non–New Zealand tax resident. Residency is a concept more applicable to trustees than to trusts, and accordingly the trustees' tax residence will remain unchanged, notwithstanding that the trust is not liable for tax in New Zealand on non–New Zealand-source income. If all the trustees of a foreign trust are New Zealand tax residents, then the possibility arises of utilising New Zealand's double-taxation treaties, notwithstanding that income earned by a New Zealand foreign trust from a treaty country will not be subject to tax in New Zealand. However, any conclusions regarding the ability to use a double-tax agreement will require detailed analysis of the terms of the specific treaty.

E. Advantages in Summary

The advantages of using a New Zealand foreign trust as an "offshore" trust can be briefly summarised as follows:

- No tax reporting obligations to the New Zealand Inland Revenue Department with respect to offshore earnings.
- Trust law similar to that of the United Kingdom.
- The significant cosmetic appeal of a trust based in a "conventional" jurisdiction of the Organisation for Economic Co-operation and Development.
- New Zealand is not on any governmental or supranational "black lists."
- Possible tax treaty relief.

F. Pre-Migration Trusts

One of the other tax planning opportunities created by New Zealand's trust taxation regime is in relation to trusts settled by nonresidents who subsequently take up tax residency in New Zealand. This includes returning expatriates, but only those who have not been tax residents of New Zealand since 17 December 1987. There is a limited but valuable window of opportunity for a person who establishes an offshore trust (with non-New Zealand-resident trustees) prior to taking up tax residency in New Zealand, in circumstances where no further settlements of any description are made upon the trust after the person takes up tax residency.

Such a trust will be treated as a foreign trust for twelve months after the date the person acquires New Zealand tax residency; thereafter the trust will be treated as a non-complying trust. However, a grandfathered non-complying trust of this nature is treated more favourably than a non-complying trust settled by a New Zealand resident. The concessions are that the offshore trustees are not deemed to be liable for New Zealand taxation on worldwide income of the trust, nor is the settlor deemed to be liable as agent of the trustees for tax on worldwide income. Consequently the trust can provide, at least, a tax deferral opportunity for migrants to New Zealand or for returning expatriates.

Income earned in the trust can be accumulated free of New Zealand tax and will be subject to New Zealand tax only if distributed to a New Zealand-resident beneficiary. Distributions of current-year income will be taxed to the beneficiary at ordinary progressive tax rates ranging from 10.5% to 33%. Distributions from past-year earnings and capital gains (in both cases, being earnings/gains derived after the trust is classified as a non-complying trust) can be taxed at a penal rate of forty-five percent. However, it is relatively easy to avoid that penal tax rate by using a double-tier trust/company structure. The trust would incorporate and subscribe for shares in an offshore company, and the investments would be held by that company.

A trust of this nature is obviously ideal for those persons who are in a position to leave a capital fund offshore, untouched, for a significant period. It is not always desirable to use a trust of this nature for capital growth investments, as those gains will be subject to capital gains tax, whereas capital gains are not ordinarily taxable in New Zealand. Consequently capital growth investments can be more favourably held by the New Zealand resident or a complying trust established by the New Zealand resident.

G. Transitional Resident Exemption

In April 2006 a tax reform was implemented for the benefit of new New Zealand residents which has the highly desirable effect of giving a four-year "tax holiday" with respect to foreign-source income.

In essence, any new migrant acquiring tax residency in New Zealand on or after 1 April 2006 has a 48-month tax exemption with respect to all foreign-source income, even if that income is subsequently remitted to New Zealand. This exemption applies to New Zealand expatriates who have been nonresidents for a minimum period of ten years.

It is necessary for any pre-migration trust to be fully settled prior to commencement of tax residency; in other words, there is not an additional four-year period of grace for settlement of a pre-migration trust. However if such a trust is established pre-residency then the twelve-month election period during which such a trust can either be converted to a complying trust or left to become a grandfathered non-complying trust will not start to run until

the expiry of the four-year period. In other words, this election period will stretch to five years from commencement of tax residency.

VI. General Anti-Avoidance Rules (Subpart BG)

There have been a number of recent cases in New Zealand which (at least from an onshore tax adviser's perspective) have caused a substantial degree of disquiet.

New Zealand has a statutory general anti-avoidance provision, and in the past the courts have interpreted it quite conservatively. The provision in question (Section BG 1 of the Act) is cast so broadly that to give it its literal interpretation would cause to be deemed "tax avoidance" just about anything having the consequence of minimizing or deferring tax, unless it was truly incidental.

From a structural perspective, the courts have generally permitted the form of a transaction to prevail over substance, unless the arrangement in question is so clearly designed, artificially, to avoid tax that the anti-avoidance provision can be invoked.

The usual indicia of avoidance are such things as:

- artificiality;
- steps in a series of transactions imposed for no commercial purpose;
- circularity; and
- transactions whose terms are not explicable by reference to ordinary commercial or family dealings.

As a result of a number of new Appeal Court decisions we appear to be in a frightening new world of substance prevailing over form, although the courts have not expressed it in these words. A number of the recent cases have been Supreme Court decisions (our final court of appeal given that appeals to the Privy Council were abolished a few years ago), which means that, like them or not, they are the last word for the time being on the matters in question. Cases of interest include the following:

- *Glenharrow Holdings Ltd v. CIR;*[2]
- *Ben Nevis Forestry Ventures Ltd v. CIR;*[3]
- *CIR v. Penny & Hooper*,[4] and
- *Krukziener v. CIR*.[5]

The key element of the new approach of the Supreme Court is the so-called "parliamentary contemplation" test. In other words, when the court looks at a particular arrangement or set of circumstances or transactions, it asks itself the question: Would parliament have contemplated the specific legislative provisions being used in this way when the legislation was enacted?

Applying this wonderful twenty-twenty hindsight test, it would seem that very few "arrangements" (and that term is defined in the statute very broadly) will escape the tax avoidance net if they involve a reasonable degree of what, historically, we would have called legitimate and acceptable tax planning.

The "parliamentary contemplation" test has come out of the ether in much the same way as the Privy Council introduced the (later discarded) "tax mitigation" concept in the *Challenge*[6] case in the 1980s, although in that case tax mitigation worked in favour of the taxpayer rather than against the taxpayer.

Endnotes

1. The term "associated persons" includes, for example, relatives within the second degree of relationship, trusts with common settlers and beneficiaries, companies with fifty percent or greater common shareholding, and two persons who are not directly associated but who are each associated with a common third person.
2. 24 NZTC 23,236 (SC 2009).
3. 24 NZTC 23,188 (SC 2009).
4. 24 NZTC 24,287 (CA 2010).
5. 24 NZTC 24, 174 (2010).
6. *CIR v. Challenge Corp. Ltd.*, 8 NZTC 5, 219 (1986).

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