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To Market, to Market: The Pros and Cons of Alternative Methods of Distribution (European Perspective) 87
Sofia Cerqueira Serra

Competition Rules for Distribution in the European Union 92
Michael Dean

International Compliance and Privilege Issues Confronting the Oilfield Services Industry 108
Brent A. Benoit and Scott L. Friedman

Confidentiality Waivers in Global Cartel Investigations 115
Heather Kafele

"I'm Never Too Far Away": Extradition of Non-U.S. Nationals Charged with Price-Fixing 121
Jay L. Himes and Rudi Julius

Anti-Cartel Enforcement in Brazil: Status Quo and Trends 132
Ana Paula Martinez and Mariana Tavares de Araujo

Corruption in Commercial Disputes Before the New York Courts and International Arbitration Tribunals 139
Julie Bédard

IS THE MADRID SYSTEM FOR INTERNATIONAL TRADEMARK PROTECTION FULFILLING ITS PROMISE?

The Colombian and Mexican Perspective and Experience 141
Alejandro Cárdenas

Thoughts from the European Union Perspective 143
Pierodavide Leardi

Will Brazil Join the Madrid System? 147
Marcos Chucralla Moherdaui Blasi

Commentary: Cross-Border Insolvency in Brazil: The Need for Rules 150
Thomas Benes Felsberg

CHAPTER NEWS

Law Report: The Sinking of Safe Harbor—and Navigating the Stormy Waters Ahead 153
Gayle McFarlane, Jonathan Armstrong and Andre Bywater

Law Report: Corruption in Sweden—A Bad Bout of Naiveté with a Bitter Cure 156
Peter Utterström, Leif Frykman and Daniel Edman

Law Report: The Patent Box in Italy—Another Step to Encourage Innovative and Long Term Foreign Investments 158
Marco Amorese

Law Report: International Legal Cooperation Act Enacted—Overview of Spain's New Regime on Judicial Assistance in Aid of Foreign Proceedings 160
Maribel Rodríguez Vargas

Law Report: New Reinsurance Regulation in Brazil 162
Vera Carvalho Pinto

Includes Chapter News

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To Market, to Market: The Pros and Cons of Alternative Methods of Distribution (European Perspective)

By Sofia Cerqueira Serra

I. Introduction

This article is a brief overview of various means for manufacturers to expand their business into new markets within the European Union, and will focus on the most common "traditional" types of distribution contracts: agency; concession/independent distribution; and franchise.

These traditional forms of distribution are appealing ways to enter into new markets through independent local players, allowing the manufacturer to expand its business without the need to set up a local structure, thus reducing (or avoiding) fixed costs, requiring less investment, and incurring less risk.

However, each of these alternatives has advantages and disadvantages that must be duly taken into account by the manufacturer and counsel to determine the best option available.

II. Traditional Types of Distribution Contracts

A. Agency

1. Definition

Article 1, sub-clause 2 of EU Directive 86/653/CEE defines "commercial agent" as a "self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the 'principal', or to negotiate and conclude such transactions on behalf of and in the name of that principal."

In other words, under an "agency" contract the agent is an independent party who promotes sales of the goods on behalf of the producer/supplier (referred to as "principal"). The agent does not take title to the goods, nor is it a party to the final sale agreement concluded between the principal and the purchaser and, consequently, it is the principal who bears the risk of the sale and of collection of payment.

In most E.U. jurisdictions, agency agreements are not subject to special formalities and may be entered into both verbally or in writing. However, upon request of either party the other must cooperate in formalizing the content of the agreement in writing. Furthermore, while there may be no specific formalities, there are certain clauses that must be in writing, such as exclusivity rights, *del credere* clauses, and non-competition duties.

2. Brief Overview of Main Rights and Duties

In addition to the general duty to look after the principal's interests and act dutifully and in good faith, the agent's main duties are to (i) make proper efforts to negotiate deals; (ii) provide the principal with all necessary information; and (iii) comply with reasonable instructions given by the principal. However, other legal duties may be established by contract, such as duty of collection, local publicity and merchandising, post-sales support, etc.

It should be noted that the agent is responsible for all costs associated with its activity and for setting up the necessary resources and structures to perform its duties. As consideration for these services, the agent receives a commission on sales it has helped to obtain in the territory.

In turn, the principal also has general duties to act in good faith and to cooperate with the agent, including the duty to (i) provide the agent with the information necessary for the latter to perform the Agency contract, including any product documentation; (ii) inform the agent of the acceptance or refusal of potential commercial transactions; and, naturally, (iii) pay the consideration due to the agent.

While E.U. countries have a specific legal regime for agency agreements as a result of the transposition of Council Directive 86/653/CEE, the existing legislation allows parties a certain degree of contractual freedom to regulate their relationship and to establish other contractual duties, such as "*del credere*" duties (whereby the agent assumes the risk of good collection and is entitled to receive special consideration) and non-competition clauses, within what is allowed by the respective legal regimes and by E.U. competition regulation on vertical restraints. Note also that, contrary to what has happened in the past, exclusivity, whether for a certain geographic territory or clients, is not an automatic characteristic of an agency agreement and should be granted in writing.

B. Independent Distributor

1. Definition

Concession or Independent Distributor Agreements take the separation between producer and the distribution chain one step further. Unlike the agent, in a concession agreement the independent distributor ("Distributor") buys the goods from the producer and then resells them in the local market in its own name and at its own risk. However, due to the continuing relationship established between the parties and the element of control of the distribution activity, the distribution contract goes beyond a mere succession of "sales agreements."

Distribution agreements are essentially characterized by three aspects:[1]

- The Distributor purchases from the producer for resale in the local market.
- The Distributor acts in its own name, on its own account and at its risk.

- The Distributor is integrated into the producer's distribution network as a result of other duties that are established between the parties.

2. Brief Overview of Main Rights and Duties

As discussed in further detail below, generally speaking concession agreements do not have a specific legal regime in most European countries and, therefore, it is essential that the parties expressly and carefully set out their respective rights and duties in the agreement.

Although the Distributor is an independent party who is responsible for the resale of the goods in the local market, the manufacturer may have an interest in maintaining some control over the distribution activity and, as a result, establishing certain obligations—such as sales targets, product packaging and presentation requirements, and post-sales duties—that contribute to the "integration" of the Distributor into the manufacturer's network and to the harmonization of the latter's commercial policies.

On the other hand, a concession scheme requires greater investment and risk on behalf of the Distributor, who will also seek to protect its interests and minimize its risks and seek to establish contractual safeguards, such as minimum contract duration, territorial exclusivity, product warranties, and indemnity provisions from the producer.

Given the absence of a specific legal regime, parties should also anticipate future problems that may arise upon the termination of their relationship, particularly in regard to compensation, unsold stock, and non-competition duties.

The matter of "compensation" will be discussed in further detail below. However, note that this is one of the aspects in which case law in various E.U. jurisdictions have allowed the analogical application in the distribution setting of the rules of termination established in the agency regime.

Another important aspect of termination is the matter of unsold stock: should the producer be required to repurchase the goods if they are in proper condition and at what price? Should the Distributor be allowed to continue to sell the goods for a certain defined period after termination? Or should the Distributor, as the rightful owner of the goods, be entitled to sell them at its own discretion and at any price? The matter of unsold stock is a key issue that the parties should address contractually to minimize their losses and to avoid further damages.

As for the matter of non-competition, although the manufacturer is not directly involved in the resale of the goods in the local market, it is in its interest to protect its market share and avoid a situation where the Distributor undermines the market by using its acquired knowledge and experience to promote a competing brand. However, it should be noted that, while these non-competition clauses are generally allowed for smaller players, they raise sensitive competition issues and must be both reasonable and limited in time. Otherwise, they may be considered "anti-competitive" and in violation of both national and E.U. competition rules.[2]

C. Franchise

1. Definition

Franchise Agreements are by far those that allow the manufacturer the greatest level of control and uniformity of its international distribution network. Under a franchise agreement, independent economic agents ("Franchisees"), acting in their own name and on their own account and risk, adopt the corporate image of the franchisor and present the goods/services in the local market "as if" they were the franchisor.

Franchise Agreements generate significant economic benefits for both parties. On one hand, they allow the franchisor to expand its commercial network, on the basis of a certain business method or specific know-how, without incurring substantial investments. On the other hand, they allow the Franchisee to enter the local market while benefiting from the support and assistance of a third party whose business has already been tested.

According to the European Court of Justice in *Pronuptia*,[3] franchise agreements can be differentiated into three categories:

- Service Franchise—The Franchisee offers the service under the franchisor's business name/trademark in accordance with franchisor's instructions.
- Production Franchise—The Franchisee manufactures the goods according to the franchisor's instructions and sells them under the latter's business name/trademark.
- Distribution Franchise—The Franchisee sells goods in a commercial establishment that bears the franchisor's name and according to the franchisor's business methods.

2. Brief Overview of Main Rights and Duties

While there is a relevant E.U. Regulation concerning competition matters that touches upon franchise agreements,[4] this does not detract from the fact that, generally speaking, franchise contracts do not have a specific legal regime in most of E.U. Member States.

Hence, once again, the agreement entered into between the parties is essential to define their respective rights and duties and, naturally, the content thereof will depend on the type of franchise (service, production or distribution) that is entered into. However, clauses common to all franchise agreements include a license to use the franchisor's intellectual property (such as its trade name or trademark and, particularly in the case of production franchises, patents) as well as the latter's know-how and access to technical or business support. In exchange, the Franchisee will pay the franchisor fees that may take the form of a lump sum ("front money") or royalties on sales, or a combination of both.

The use of the franchisor's "corporate image" is an essential element of the franchise agreement (and a key characteristic that distinguishes the Franchise from a mere transfer of know-how or license agreement) and, while it allows the Franchisee to benefit from an established trademark/trade name and tried business method, it can also raise liability issues, since the Franchisee is portrayed to the public as the apparent or presumed manufacturer. On the other hand, because of this "corporate identity," the franchisor will seek to ensure that the Franchisee complies with its instructions, so as to maintain a good reputation and ensure the quality of the goods/services and thus maintain uniform quality standards throughout the franchise network.

Similarly to concession agreements, the parties should also be concerned with establishing clear rules regarding sales targets, territorial exclusivity, product warranties and indemnity provisions and, again, strive to anticipate problems that may arise upon the termination of the agreement.

III. Legal Framework and Practical Considerations

A. Agency Contracts

As referred above, agency contracts have a specific legal regime within E.U. Member States as a result of the transposition of Council Directive 86/653/EEC. However, although the aforementioned Directive harmonizes the concept and basic rules of agency agreement, it also results from a "compromise" among the various Member States and, to such extent, allows them sufficient flexibility to adopt solutions in line with their respective internal jurisdiction and practice.

For example, Article 17 of Council Directive 86/653/EEC,[5] which relates to termination, is clearly a result of "compromise" between the German and French positions and allows each Member State to choose between the German model of an "indemnification"[6] or the French-model of "compensation"[7] that may be due to the agent upon termination of the agency agreement—provided the requirements established by law are verified.[8]

Under the "indemnification" model, the amount of the indemnity is determined equitably and must not exceed a figure equivalent to an indemnity for one year calculated from the agent's average annual remuneration over the preceding five years or, if the contract is of shorter duration, average for the period in question.

Under the "compensation" model, the Directive refers to no limit and the amount of compensation is based on the actual damages suffered. However, while there is no statutory limit to the "compensation" granted to the agent, in France, for example, the courts have generally upheld an indemnification in the amount equivalent to two years of commissions.

In Portugal, agency agreements are governed under Decree-Law DL 178/86 of 3 July 1986, subsequently altered by DL 118/93 of 13 April 1993, as a result of the transposition of EU Directive 86/653/CEE), and the options made by the Portuguese legislature clearly follow the German model.[9]

B. Concession and Franchise Agreements

In general, most European countries do not have a specific legal regime for concession agreements. However, there are certain exceptions, as is the case of Belgium.[10] The same is true of franchise agreements, with the exception of Italy and to a certain extent France (in light of the *Loi Doubin*,[11] which imposes certain duties of information), despite the existence of relevant E.U. regulations concerning competition matters that touch upon these contracts.

While most Member States do not have a specific legal regime for concession and franchise agreements, case law has supported the analogical application of certain agency rules to concession agreements—particularly in regard to termination. However, the application of the agency rules to other forms of contract is not "automatic," and the grounds for "analogy" should be determined on a case-by-case basis and can raise challenging questions.

For example, in what concerns the right to compensation/indemnification on termination, the courts often weigh whether the activities of the individual distributor contributed to obtaining new clients or increasing sales to existing clients and the degree of their integration into the producer's distribution network. The analogy it even more difficult to uphold in relation to franchise agreements, where the Franchisee is acting under the corporate name/corporate image of the franchisor, leading significant authors and case-law to deny the analogical application of the agency rules to these contracts.

Another challenge relates to the calculation of the compensation/indemnification due—while the Agent receives commissions, independent distributors and franchisees receive margins, and there is no uniform case law on whether gross margins or net margins should be used for purposes of determining the compensation/indemnification due.

Under Article 15 of Council Directive 86/653/EEC, an agency agreement that is concluded for an indefinite period may be terminated by either party with a prior notice of one, two or three months, depending on the duration of the contract. However, such short notice periods are unreasonable for concession/franchise agreements, where a greater investment is made by the independent distributor/franchisee.

These are some of the challenges that are faced by courts and which lead to conflicting decisions and to legal uncertainty that could be prevented by the parties through cautious drafting of their agreement.

IV. Basic Insights on E.U. Competition Policy on "Vertical Agreements"

From a competition perspective the distribution agreements we have been discussing constitute forms of

"vertical agreements," since they govern the relationship between entities at different levels of the distribution chain. These agreements often include restrictions on each party's activity, such as exclusivity clauses, territorial exclusivity, restrictions on suppliers and the terms of sale, restrictions on "parallel" imports, non-competition duties, etc.

Some of these restrictive terms are frowned upon by the E.U. and Member-State competition laws, but because they form such important characteristics of distribution contracts and have the potential to enhance efficiency and benefit the market, they may, in certain circumstances, be excluded from the general prohibition, as long as the clauses remain within certain limits and the healthy competition of the market can still be ensured.

Article 101 of the Treaty on the Functioning of the European Union (former Article 81 TEC) applies to vertical agreements that may affect trade between Member States and that prevent, restrict or distort competition on the market and are detrimental to consumers. Article 101(1) prohibits those agreements that are considered anti-competitive:

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
   (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
   (b) limit or control production, markets, technical development, or investment;
   (c) share markets or sources of supply;
   (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
   (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

However, the prohibition contained in Article 101(1) may be cast aside, and the agreement in question exempted, if all four cumulative conditions for exemption set out in Article 101(3) are satisfied, and the agreement in question:

— contributes to improving the production or distribution of goods or to promoting technical or economic progress;

— allows consumers a fair share of the resulting benefit;

— does not impose on the parties restrictions which are not indispensable to the attainment of these objectives;

— does not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

The structure of Article 101 thus provides for a general prohibition of distribution agreements containing anti-competitive clauses but also allows for the possibility that an agreement may be exempted, and the prohibition inapplicable, if the conditions of Article 101(3) are satisfied.

Generally speaking, it is for the parties to a distribution agreement to analyze the potential anti-competitive effects of their agreement and to weigh them against the countervailing factors which may confer exemption. This means that the parties carry out a self-assessment of the competitive implications of their agreement without the intervention of any competition authority: exemption is not conferred by an administrative act but as a result of the agreement's compliance with all conditions of Article 101(3).

The E.U. legislation obviously sought to strike a balance between the restrictions to competition and the benefits that certain "vertical agreements" confer which outweigh their anti-competitive effects, provided these "vertical agreements" do not contain any "hard-core restrictions."

In some cases, depending on the market share of the buyer and the supplier, the distribution agreements in question may benefit from a presumption of legality as a result of Commission Regulation 330/2010 (the "Block Exemption Regulation").[12]

Under this "Block Exemption Regulation," it is assumed that, when the market share held by each of the involved undertakings does not exceed thirty percent and the agreement does not contain severe restrictions to competition, then such vertical agreements generally lead to an improvement in the distribution chain that ultimately benefits consumers. This provides a safe haven for undertakings who are party to a vertical agreement.

However, agreements that contain severe restrictions, such as minimum and fixed resale prices, as well as certain restrictions concerning territories a Distributor may sell in or groups of clients it may sell to, do not benefit from the "Block Exemption" under any circumstances, regardless of the market share held by each of the involved undertakings.

Even if the conditions for an agreement to be exempted are not satisfied, for example, the thirty-percent limit on market share is exceeded, this does not automatically mean that a vertical agreement containing some form of competitive restriction will fall under the prohibition of Article 101(1). A case-by-case analysis must be carried out by the parties, in a self-assessment, to determine whether the agreement in question may individually benefit from the exemption under Article 101(3).

The application of Article 101 is also the object of the European Commission Guidelines on Vertical Restraints,[13] which seek to provide additional clarity and legal certainty to undertakings involved in distribution relationships in the European Union and to assist parties in their self-assessment. For such purpose, it may be relevant to point out a few final considerations:

First, Article 101 only applies to agreements that affect trade between Member States and restrict competition.

Second, Article 101 only applies when independent undertakings are involved—this means agreements between members of a single group of companies will not be caught by Article 81(1), unless the individual companies enjoy a high degree of independence in determining their actions on the market. According to the "single economic unit" doctrine, legally autonomous undertakings which form part of the same corporate group will generally be treated as a single undertaking.

Third, in what concerns agency agreements, the agreement will be qualified as an agency agreement if the agent does not bear any substantial financial risk, or bears only insignificant financial risks, in relation to the contracts concluded and/or negotiated on behalf of the principal. Article 101 will not apply to agreements between genuine agents and their respective principals in regard to those agreements concluded by the Agent on behalf of the principal.

Endnotes

1. Antonio Pinto Monteiro, Contratos de Distribuição Comericial 108-110 (2002).
2. Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, Official Journal L 102, 23 April 2010, at 1-7, pursuant to which certain vertical agreements can be regarded as normally satisfying the requirements of Article 101 (3) and, therefore, benefit from a presumption of legality, provided the involved undertakings do not hold a market share exceeding thirty percent of the relevant market and do not contain any so-called "hardcore" restrictions ("Block Exemption"). The "Block Exemption" recognizes that non-competition in clauses may have an efficiency-enhancing effect and establishes the criterian necessary for such non-competition clauses to benefit from the exemption, such as, a five-year limit to their overall duration and a one-year limit for post-term non-competition provisions.
3. Judgment of the European Court of Justice (28 Jan. 1986)—*Pronuptia de Paris GmbH vs. Pronuptia de Paris Irmgard Schillgalis*, Case No. 161/84.
4. *See* Council Regulations No. 4087/88, subsequently replaced by Regulation No. 2790/1099 and now by Council Regulation No. 330/2010 on the Application of Article 101(3) on the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, note 2 *supra*.
5. Article 17, paragraph 1 of Council Directive 86/653 states: "Member States shall take the measures necessary to ensure that the commercial agent is, after termination of the agency contract, indemnified in accordance with paragraph 2 or compensated for damages in accordance with paragraph."
6. Article 17, paragraph 2 of Council Directive 86/653 establishes as follows:

   (a) The commercial agent shall be entitled to an indemnity if and to the extent that:

   – He has brought the principal new customers or has significantly increased the volume of business with existing customers and the principal continues to derive substantial benefits from the business and such customers; and

   – The payment of the indemnity is equitable having regard to all the circumstances and, in particular, the commission lost by the commercial agent on the business transacted with such customers. Member States may also provide for such circumstances also to include the application or otherwise of a restraint of trade clause, within the meaning of Article 20;

   (b) The amount of indemnity may not exceed a figure equivalent to an indemnity for one year calculated from the commercial agent's average annual remuneration over the preceding five years and if the contract goes back less than five years the indemnity shall be calculated on the average for the period in question;

   (c) The grant of such an indemnity shall not prevent the commercial agent from seeking damages.
7. Article 17, paragraph 2 of Council Directive 86/653 states as follows:

   The commercial agent shall be entitled to compensation for the damages he suffers as a result of the termination of his relationship with the principal. Such damages shall be deemed to occur particularly when the termination takes place in circumstances:

   – depriving the commercial agent of the commission which proper performance of the agency contract would have procured him whilst providing the principal with substantial benefits linked to the commercial agent's activities,

   – and/or which have not enabled the commercial agent to amortize the costs and expenses that he had occurred for the performance of the agency contract on the principal's advice.
8. It should be noted that the payment of the indemnification or compensation is dependent upon the verification of the legal requirements established under national law, and no indemnity or compensation is due to the Agent upon termination if (i) the agreement is terminated by the principal as a result of the default attributable to the Agent, (ii) there is unjustified termination of the agreement by the Agent or (iii) if the Agent has assigned its rights/duties to another person, with the principal's consent.
9. The German model was also followed by Austria, Belgium, Holland and Italy, among others.
10. Law of 27 July 1961, subsequently altered by Law of 13 April 1971.
11. The designated *Loi Doubin* was passed on 31 December 1989 and was subsequently complemented by Decree No. 91-337 of 4 April 1991 and imposes a duty on the franchisor to provide the potential franchisee with certain preliminary information concerning the franchisor's business and experience, the possible market growth and key terms of the agreement relating to exclusivity, term, renewal and termination, thus enabling the Franchisee to make an informed decision.
12. Commission Regulation 330/2010 of 20 April 2010 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, note 2 *supra*.
13. Commission Notice, Guidelines on Vertical Restraints, Official Journal C 130, 19 May 2010, at 1.

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Competition Rules for Distribution in the European Union

By Michael Dean

I. Europe's Legal Framework

Distribution in Europe mostly involves the usual commercial challenges of a supply relationship. Like many other regions in which to distribute goods, regulatory considerations have a major impact on commercial arrangements here. Both physical and online distribution in Europe are affected by the obsession with territorial issues, and pricing restraints is another key area. But other general policies have an impact. In addition to outlining the minimum rules and their framework, this article will briefly address other commercial laws and policies affecting distributorships and agencies. Of course, as with many antitrust regimes, the law and policy start from the premise that a reseller should be free to determine to whom, where, how and at what price it sells. However, that is not the real, or particularly efficient, commercial word.

Europe is both a unified area for many principles relevant to distribution and a patchwork of twenty-eight countries (perhaps thirty legal systems), several currencies and many languages and cultures. Distribution in Europe may be affected by domestic Member State laws, European Union and national competition laws applicable to vertical agreements, and possibly the law of another third state as the law of the contract.

It may be useful to set out the basic approach of E.U. antitrust law to vertical arrangements and, in doing so, briefly to describe the E.U. regime and the interaction with Member State law.

For the most part E.U. antitrust law heavily influences individual Member State competition laws, especially on vertical and horizontal restraints: Member State authorities must apply E.U. antitrust law as well as their domestic laws. The European Commission drives E.U. antitrust policy and enforces antitrust law. Therefore, with some exceptions an arrangement compliant with E.U. antitrust law should be compliant with competition laws of Member States and, in principle, vice versa. E.U. policy is largely driven by the aim of creating a single European market and there is much focus on limiting the extent to which the European Union is divided up by a supplier.[1]

II. European Competition Law

E.U. competition law is based principally on two Treaty provisions, Articles 101 and 102 of the Treaty on the Funding of the European Union,[2] as well as a range of EC Regulations, Commission Notices, decisions and European Court judgments. Article 102 prohibits an abuse of market power (dominant undertakings) and is dealt with briefly later, but first Article 101.

A. Article 101(1)

1. Art 101 TFEU

Article 101(1) prohibits:

> all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market…

The prohibition is automatic, needing no intervention by any authority. Equally automatic is the possibility of meeting exemption criteria in Article 101(3) and therefore of being enforceable and valid.

Typical examples of distribution arrangements caught by Art 101 are the following:

- Attempts by the supplier to prevent a distributor from selling outside its allocated territory or to purchasers who intend to resell outside the distributor's territory, *i.e.*, protecting other territories from parallel trade.[3]
- Attempts by the supplier to set fixed or minimum prices for distributors' downstream sales, or to prevent distributors granting discounts.[4]
- Attempts by the supplier to discourage or control online reselling by distributors.[5]
- Excessively long-term distribution agreements, tying in the "weaker" party.[6]
- Excessively exclusive agreements, foreclosing the market to competitors.[7]

More recently, the authorities have examined online selling platforms, the restrictions brand owners place on resellers, and the restraints which platforms place on the suppliers which use them.[8]

2. Restrictions by Object or Effect

There has been periodic consideration of the hugely uninteresting but important distinction between agreements which are anti-competitive "by object" and those "by effect." If anti-competitive by object—which broadly means a restraint liable on its face seriously to inhibit competition (such as agreements between competitors on future pricing), then the authorities need not go through a burdensome effects analysis before condemning it.[9]

3. Art 101 TFEU: Agreement "Between Undertakings" or Internal to Group or Agency?

To have an agreement, two parties are needed. Many antitrust problems between supplier and distributor can be avoided by taking distribution "in-house"; *i.e.*, by having wholly or partly owned subsidiaries which do not enjoy autonomy undertaking distribution. Article 101 applies to agreements only between independent undertakings. If a subsidiary lacks autonomy, Article 101 will not apply to an "agreement" with its parent.[10] In *Viho*, territorial restraints prohibiting distributors from selling outside their territories were not caught by Article 101(1): the distributors were all subsidiaries, forming part of the same economic unit.[11]

Dealing through an agent can also allow a supplier to control the price and to whom the goods are sold. The agent—if a "true agent"—is regarded as integrated with the supplier. The obligations imposed on a genuine agent in relation to the sale of the principal's goods fall outside Article 101. There is case law to assist in determining whether the agent can be regarded as integrated or whether it should be regarded as a distinct entity.[12] The European Commission in the *E-books* case[13] proceeded against five publishers of e-books despite the fact that the publishers each had agreed with Apple to sell their books for Apple devices on an agency basis, which might have allowed them to control the retail prices: the problem was that the move to agency was pursuant to an alleged concerted practice among the publishers and Apple to allow the publishers to resist the downward price pressure of Amazon. This was reinforced by an MFN clause which obliged the publishers to match on Apple's ibookstore any lower prices available from other online retailers. Article 101 can still apply to the relationship between the principal and its agent in connection, with issues such as obligations not to handle competing goods and exclusivity.

4. Effect on Trade Between Member States

European Union competition law applies where there is an appreciable effect on trade between Member States, as determined pursuant to a test interpreted broadly in case law and guidance.[14]

European Commission guidance presumes an agreement has an insufficient effect on trade where:

— the aggregate market share of the parties on any relevant market in the European Union affected by the agreement is not more than 5%; *and*

— for vertical agreements the supplier's turnover in the products affected by the agreement is below €40m in the European Union (for horizontal agreements the parties' turnover in the European Union must be no more than €40m.

Care must be taken when applying this presumption.

5. Appreciable Effect on Competition—The *De Minimis* Test

Not all restrictive agreements are caught by E.U. competition rules, even if there is an effect on trade between Member States. Only agreements which have an appreciable economic impact are caught by Article 101.[15] The European Commission has indicated that agreements between competitors may be regarded as *de minimis* if the parties have a combined market share of less than ten percent. Where parties are not competitors, and provided there are no serious or hardcore provisions, either party's market share would have to exceed fifteen percent before Article 101 was applicable. Where parallel networks of agreements restrict competition in a market, *de minimis* thresholds are reduced to five percent for all agreements.[16]

The De Minimis Notice follows the approach of a recent decision of the ECJ which confirmed that *any* agreement which has as its *object* the distortion, prevention or restriction of competition will be presumed to have an appreciable effect on competition.[17] Therefore, all restrictions "by object" will be caught by Article 101(1)—even below *de minimis* market share levels. This would include so-called "hard-core" restrictions, such as export bans, price-fixing and market sharing agreements, or resale price maintenance and certain territorial restrictions, but would also include any other form of restriction "by object" (a concept which has recently been clarified to a degree, though still not satisfactorily, by the ECJ).[18] The Commission has also produced guidance on the type of conduct which will be regarded as a restriction of competition "by object," which consolidates much of the recent case-law.[19]

6. Territorial Reach of Art 101

Article 101 can apply to an agreement between two non-E.C. undertakings entered into outside the Union where that agreement is implemented, wholly or partly, within the Union.[20] This may fall short of the U.S. "effects doctrine," but is broad nonetheless. In *Javico v. Yves Saint Laurent*, a restraint on distributors in Russia and the Ukraine exporting was held to have an effect in the European Union and to infringe Article 101(1).[21]

7. Consequence of Infringing

For most genuine commercial arrangements, the main competition law concern is whether any important restraints are enforceable. The offending part of an infringing agreement, or the entire agreement if the offending part cannot meaningfully be severed, will be void and unenforceable unless the agreement is exempt under the exemption criteria in Article 101(3) discussed below.

For serious infringements, of course, national authorities and the European Commission may impose fines of up to ten percent of parties' worldwide annual turnover, although the cap varies between authorities—as does the approach to calculation of fines.[22]

Damage actions against third parties adversely affected by anticompetitive agreements or abuses of dominance are becoming more common in Europe and this has been made easier by the European and Member State authorities.[23]

B. Art 101 TFEU: The Article 101(3) Exemption

1. Exemption

Falling within Article 101(1) is not fatal: it is still possible to meet the criteria for exemption under Article 101(3) where an agreement:

> contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit,

and which does not:

(a) impose restrictions which are indispensable to… those objectives; and

(b) afford such undertakings of possibly eliminating competition in respect of a substantial part of the products in question.

2. Art 101 TFEU: Block Exemptions—The Safe Harbors

Given the uncertainty of an assessment under Article 101(3) criteria, it is attractive to ensure an arrangement falls within one of the "Block Exemption Regulations" that exempt specific categories of agreements.[24]

C. Vertical Agreements Block Exemption

Most vertical agreements are enforceable and unaffected by competition law, either because they contain no restraints on the supplier or the reseller; the agreement is insignificant in terms of the market shares of the parties; or they are drafted in order to satisfy the Vertical Agreements Block Exemption Regulation (the "VBER").[25] Broadly, that exempts agreements which do not involve parties with high market shares and which contain acceptable restraints. It is necessary to assess an agreement not covered by the VBER against the criteria in Article 101(3) on its individual merits.

1. Basic Requirements for Safe Harbor

The VBER safe harbor is for agreements which relate to the conditions under which the parties may purchase, sell or resell certain goods or services. An agreement which has, as its primary objective, the transfer of intellectual property is not covered by the VBER.[26]

A fundamental requirement is that the market shares of each of the parties (the supplier on the selling market, the purchaser as the buying market) does not exceed thirty percent. If either of them exceeds such a share, the VBER is not available. The European Commission's Guidelines on Vertical Restraints of 2010 are a useful guide and commentary, although now potentially liable to amendment as part of the European Commission's review of its e-commerce strategy.

2. Unenforceable Restrictions

The VBER lists common restraints, some which do not meet the VBER and may be unenforceable, but that fact does not prevent other provisions enjoying the protection of the VBER.[27] Others are so heinous that their presence in an agreement prevents the block exemption from applying at all to the agreement.[28]

D. Severable Clauses

1. Non-Competes or Exclusive Purchasing

These are enforceable under the VBER, provided they do not endure for too long. Obligations on the buyer to purchase more than eighty percent of its total requirements from the same supplier fall under this heading).[29] They are not protected by the VBER where the duration of the obligation exceeds five years or is indefinite or automatically renewable.[30]

2. Post-Term Covenants

These are not generally automatically exempted in distribution agreements, but they will be enforceable if necessary to protect "substantial" know-how, they have a duration of less than one year and are limited to the premises from which the buyer has operated during the contract period. Those conditions are met in most retail franchise agreements.

3. Targeted Non-Competes within a Selective Distribution System

A supplier can prohibit resellers in a selective system from selling competing products in general, as long as the duration of that obligation is not capable of exceeding five years. But the restraint may not be targeted so as to exclude "particular competing suppliers."[31]

E. Hard-Core Restraints

No provision in an agreement which contains a hard-core provision can be exempted by the VBER. Although there is no presumption that the agreement is illegal—it may meet the exemption criteria—a hard-core restriction is not likely to be enforceable. Article 4 of the VBER lists the following as hard-core restrictions.

1. Resale Price Maintenance

There has been debate in the European Union, after the *Leegin* case,[32] on Resale Price Maintenance ("RPM"), but little has changed. RPM is generally prohibited *per se*, in effect.[33]

Under the VBER, no protection is available where the supplier directly or indirectly dictates fixed or minimum resale prices of the buyer. Recommended or maximum sales prices are acceptable, but should be analyzed care-

fully to ensure they do not constitute indirect resale price maintenance. In 2001, Volkswagen was fined €31m for attempts to maintain resale prices of one VW model in Germany by monitoring resale prices and circulating letters "warning" distributors against selling below VW's recommended resale price ("RRP"), overturned on appeal.[34] Other forms of indirect resale price maintenance include the following.

- Fixing maximum discounts from prescribed prices.
- Making supplier rebates and reimbursement of promotional costs subject to downstream pricing level.
- Inducing or pressuring the dealer to sell at prices linked to a competitor's resale prices.[35]
- Threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations.[36]

The VBER Guidelines suggest an efficiency defense is available where RPM is used:

— during the introductory period of expanding demand;

— during a coordinated short term low price campaign (two to six weeks) in a franchise system (a distribution system applying a uniform distribution format);

— in relation to complex/experience products, where the extra margin would allow distributors to provide additional pre-sales services and free-riding is a problem.

A ban on supplying discounting outlets would be regarded as interference in pricing policy—except possibly where the ban was imposed in the context of protecting the culture and prestigious image of a brand or mark and contained in a trademark license.[37]

There is no mention in E.U. guidance of Minimum Advertized Pricing programs, a common practice in the United States. It is likely that such a practice in the European Union would be viewed as an indirect means of RPM and would not benefit from exemption. Nor is there acceptance of an equivalent of the *Colgate* doctrine. That approach would readily be regarded as involving consensus or acquiescence.

National competition authorities are particularly active in the area of resale price maintenance. Some examples of national fines for RPM include: BSH Hvidevarer (€200,000, Denmark: appliances); Unilever (€200,000, Denmark: ice cream); Kronoplast (€3,400,000, Poland: wood board producers); TTS Tooltechnic (€8,200,000, Germany: trade tools); Iittala (€3,000,000, Finland: glassware); HUSKY (€90,000, Czech Republic: outdoor clothing); Lise Aagaard Copenhagen (€80,500, Denmark: jewelery); Kofola (€527,000, Czech Republic: soft drinks).

National authorities may take different approaches. Germany, for example, takes a strict view on discussing resale prices with retailers and recommended resale prices should be communicated only once and discussed no further. As recently as January 2016, Lego was fined €130,000 by the *Bundeskartellamt* for allegedly forcing sales representatives to raise their retail prices. In comparison, the United Kingdom. recently considered the discussion of retail prices between manufacturer and retailer in a case relating to sports bras. The investigation was closed by the authority. It seems this case turned on whether communications on RRP necessarily equated to an RPM agreement. It was argued that there are good commercial reasons why manufacturers may wish to discuss RRPs, particularly when they have carried out significant market research on market positioning. The U.K. authority concluded that the parties had provided credible alternative explanations for the email correspondence between the parties which materially undermined the CMA's original objections. On the other hand, the Dutch Competition Authority has indicated that pursing enforcement action against resale price maintenance is not a priority.

2. Market Partitioning

Generally, buyers (and their customers) should be free to resell without restraint. Restricting sales by the buyer outside specified territories or specified customers is a serious restriction, whether imposed directly (by contract)[38] or indirectly (*e.g.*, by an incentive scheme).[39] Schemes designed to monitor the destination of goods (*e.g.*, differentiating serial numbers) may be regarded as illegally facilitating market partitioning. However, market partitioning can be acceptable to some degree, in the following circumstances.

In the case of exclusive distribution rights, a supplier may legally prevent a buyer from selling actively to customer groups or territories reserved exclusively for the supplier or to another buyer. The supplier must not restrict a buyer's ability to make sales into reserved areas in response to unsolicited demand; *i.e.*, from making passive sales.[40] Consequently, suppliers cannot offer distributors within the European Economic Area ("EEA") absolute territorial protection from parallel imports from other EEA territories, even where they have an exclusive distribution network.

Where distributors have non-exclusive appointment, they cannot be protected either from active or passive sales.

However, restrictions on all sales, even passive sales, are acceptable in some exceptional cases, such as new product launch. Restraints necessary to create a new product market or to introduce an existing product on a new market are acceptable. Even restraints on parallel imports will be acceptable for two years, insofar as intended to protect a distributor in a new geographic market.[41]

3. Certain Restrictions Within a Selective Distribution System

Selective distribution allows a supplier to restrict the handling of its products to dealers meeting certain criteria, for example, relating to the quality of the outlet. This is often preferred for products which require a high level of expertise, such as high-tech products and products which rely heavily on brand image.[42] This is permissible, subject to certain conditions.[43]

Sales to end-users by retailers in a selective system cannot be restricted. That is the case for both active and passive sales. Furthermore, members of a selective system must be permitted to supply one another.

4. Price Discrimination/Dual Pricing

Pricing is a key consideration in sales and distribution. Suppliers may wish to price differently between customers according to their location or other factors. Great care must be taken with this in the European Union where this may inhibit cross-border trade.

Provided a supplier is not dominant (and, as discussed below, dominance may begin at market shares of forty percent and above), it is free to price its products as it chooses. Suppliers can charge different prices to direct distributors according to their location. In practice, this allows a company to direct its non-autonomous subsidiary in one territory not to sell products to customers located in other territories. Instead, that subsidiary can refer those customers to the associated company in their own territory. Dominant companies should avoid this activity.

European Commission guidance also provides that a dual pricing agreement between a supplier and an independent distributor may fulfil the conditions of Article 101(3) in some limited circumstances. For example, when offline sales include installation by the distributor but online sales do not, the latter may lead to more customer complaints and warranty claims and may, therefore justify different pricing on- and off-line.

(a) Agreements to Restrict Parallel Trade

Price discrimination devised to restrict where dealers can resell the products will infringe Article 101.[44] This typically involves "dual pricing policies," which offer discounts for products which are resold only locally or charge a premium price for products intended for export.

Dual pricing will rarely be regarded as unilateral conduct. Rather such policies are the result of vertical agreements between the supplier and distributor that have as their object and/or effect the restriction of intra-brand competition contrary to Article 101(1). In the *GlaxoSmithKline* case[45] the ECJ agreed with the European Commission that operating a dual pricing system—products sold to wholesalers in Spain at a lower level than those destined for export—violated Article 101(1), but did not find that they were, at least in the context of the pharmaceutical industry, per se prohibited, but should be assessed according to their effects. The ECJ also concluded that, for an agreement to exist, it is sufficient for the parties to show a joint intention to conduct themselves on the market in a specific way. Signing the sales conditions (which contained dual pricing) and returning them to GSK indicated GSK's and the wholesalers' joint intention to adhere to the conduct and limit parallel trade.[46]

(b) Price Discrimination Amounting to an Abuse of Dominance

Discriminatory pricing by dominant companies (including discrimination based on nationality or location) for customers who are equivalent is prohibited[47] unless the difference in treatment can be objectively justified (*e.g.*, by genuine cost savings or market conditions). One case suggested that a dominant company is permitted to set different prices between various Member States where there are already distinct geographical markets and the differences relate to the variations in the conditions of marketing and competition, although that should be treated as exceptional.[48]

5. Most Favored Nation or Customer Clauses

Until recently, such "most-favored customer" clauses (or MFC clauses) were relatively unexplored in E.U. or U.K. antitrust law.[49] A spate of cases has, however, highlighted their prevalence,[50] particularly in relation to online retailing and has forced the authorities to take a closer look at their effects.

Such clauses are particularly likely to raise competition concerns when imposed by suppliers collusively[51] or where the customer benefiting from the clause is dominant and the effect of the clause is to reduce the incentive of the supplier to offer other customers discounts, aligning prices at a higher level than would otherwise be the case. This may not be very likely in a distribution context and, in the absence of other restrictive effects, MFCs may be enforceable.

The scope of the MFC may also be important to its assessment, particularly in an online context, where products or services are sold via a number of different channels. In a recent investigation in the United Kingdom into the private motor insurance sector, the CMA drew a distinction between the use of "narrow" and "wide" MFCs in agreements between private motor insurance providers and price comparison websites (PCW). Although the CMA recognized that MFCs with PCWs may result in efficiencies (such as reducing search costs for customers), it concluded that it was not necessary for MFCs to be drafted widely to achieve those benefits. Therefore, it found that "narrow" MFCs which require that the price on the insurer's own website is no cheaper than that offered to the PCW were acceptable. "Wide" MFCs, which require that the price offered to the PCW be no higher than the

price offered by the insurer directly or via any other channel, are now prohibited by means of an Order.[52] Booking.com and Expedia settled the ongoing investigations into its MFCs with hotels on a similar basis, *i.e.*, by narrowing the scope of the restriction to prices offered by hotels directly, rather than prices offered in other sales channels. These commitments have been accepted in a number of European Union countries. In January 2016, Germany's competition authority reportedly took a tougher stance, prohibiting Booking.com from applying narrow MFN clauses, maintaining that, as long as hotels cannot set prices on their websites in absolute freedom, the clauses will still be restrictive.

6. Territorial Restraints and Online Trade

The VBER and the respective accompanying Guidelines aim to encourage an increase in online distribution. European policy is that every distributor must be free to use the internet to advertise or sell products. How does that square with the right to allocate territories exclusively and therefore to restrict active sales efforts by other dealers? The imposition of a restriction on internet sales could be justified if the restriction related to active sales efforts into the exclusive territory or customer group of another distributor, as with physical sales. However, using the internet as a sales medium is not in itself considered a form of active sales. The 2010 Guidelines discuss restraints and how territorial restraints and internet sales co-exist in more detail.

The following are unacceptable restrictions of online sales.

- Agreeing that the (exclusive) distributor shall prevent customers located in another (exclusive) territory from viewing its website or shall put on its website automatic rerouting of customers to the manufacturer's or other (exclusive) distributor's websites.
- Agreeing that transactions are to be cancelled when credit card addresses reveal the purchaser to be located in another territory.
- Agreeing that the distributor should limit the proportion of sales made over the internet. A supplier may insist on an absolute amount of sales being made offline.
- Agreeing that higher prices are paid by the dealer for products intended to be resold online. A fixed fee can be agreed to support the offline or online sales efforts.

Where a website is accessible to all and does not target certain customers, then it is not regarded as making "active" sales. Where a customer visits the website of a distributor, contacts that distributor and the contact leads to a sale, then that is considered passive selling. Insofar as a website is not specifically targeted at customers primarily inside the territory or customer group exclusively allocated to another distributor, for instance, with the use of banners or links in pages of providers specifically available to these exclusively allocated customers, the website is not considered to be a form of active selling.

Sending unsolicited e-mails to individual customers or groups is active selling, as is paying a search engine or online advertiser to have adverts displayed to users in a particular territory.

7. Selective Distribution and Online Standards

The European Commission's Guidelines state that "a supplier may require quality standards for the use of the internet site to resell his goods, just as the supplier may require quality standards for a shop or for selling by catalogue or for advertising and promotion in general."[53] This is particularly relevant for selective distribution, but may also apply to ordinary distribution arrangements. However, an outright ban on internet sales is possible only if there is an objective justification.[54] Restrictions equivalent to those imposed on shop retailers may also be imposed on internet retailers. In that context, it is possible to impose purely qualitative restrictions, on the basis of objective criteria, *e.g.*, training required for sales staff, point of sale service, and the range of products being sold. Qualitative criteria are likely to be acceptable for products which justify selective distribution. They need not be identical but should pursue the same objectives and achieve comparable results. Any difference in the criteria should be justified by the different nature of the two different distribution modes.

Suppliers may require distributors to have one or more bricks and mortar shops as a condition for becoming an authorized dealer. The use of third party platforms may also be subject to any such conditions for the use of the internet (for instance, that customers do not click through to the distributor's website from a site carrying the name or logo of the third party platform, *e.g.*, eBay). The German competition authorities recently objected to the terms offered by Asics restricting online sales, especially of small and medium-sized dealers, by which it completely banned its distributors from selling its products on online marketplaces such as Amazon and eBay. Asics also prohibited its dealers from using price comparison engines for e-commerce and from using Asics brand names on the websites of third parties to guide customers to their own online stores. Asics has now dropped these restraints, as did Adidas in relation to similar restraints.

Although dealing with mail order rather than online sales, the European Commission's 1991 *Yves Saint Laurent* decision[55] illustrates the Commission's approach. The European Commission held that YSL's selective distribution system for luxury cosmetics, including a total ban on mail-order sales, was justified as it was necessary to ensure the presentation of the products in a homogeneous way. The European Commission's decision was essential-

ly upheld on appeal to the ECJ in the *Leclerc* case.[56] The 1991 *YSL* decision was up for renewal in 2001. However, following the adoption of the VBER and the Guidelines, the European Commission considered that a complete ban on internet sales was not acceptable. YSL therefore applied selection criteria authorizing approved retailers already operating a physical sales point to sell via the internet as well. This was accepted by the European Commission.[57]

In the French case, *Pierre Fabre Dermo-Cosmetique SA v. Alain Breckler,*[58] PFDC asked the court to order Breckler to cease selling PFDC's cosmetic products online. PFDC and Breckler had a selective distribution agreement, but that agreement did not contain any references to sales over the internet. The Tribunal held that restrictions on sales in selective distribution agreements must be interpreted narrowly. Since there was no mention of online sales in the agreement, a ban could not be implied. Online selling was merely an addition to Breckler's traditional marketing methods, and could not be stopped by the Tribunal.

In another case, also involving PFDC, the French competition authority fined the company for seeking to restrict its selected distributors selling online.[59] Although some of the products concerned were "parapharmaceutical," the authority distinguished them from pharmaceuticals proper, and concluded that the existing network of selective distribution was sufficient to protect the manufacturer's interest in safeguarding brand reputation, without the need or justification for an outright ban on online sales. The fine was set at a low level due to "the circumstances of the case" and the limited effect of the conduct.[60]

PFDC challenged the decision before the Paris Appeal Court, which asked the ECJ whether a general and absolute ban on internet selling amounts to a restriction of competition "by object" and whether such an agreement may benefit from an exemption.

The ECJ held that selective distribution agreements are, in the absence of objective justification, restrictions by object.

The ECJ confirmed that selective distribution may pursue a legitimate aim which justifies a reduction in price competition and would not infringe Article 101(1) TFEU. This will be the case where the conditions outlined above are met, *i.e.*:

- objective criteria of a qualitative nature;
- applied in a uniform and non-discriminatory fashion;
- nature of products necessitate such a network; and
- criteria do not go beyond what is necessary.

However, the Court went on to say that a de facto ban on internet sales did not have a legitimate aim and was not objectively justified. The need to maintain a prestigious image was not a legitimate aim for restricting competition.

Furthermore, the exemption regulation was not available as a ban on internet sales prevented passive sales to end users contrary to the block exemption. Whether an individual exemption under Article 101(3) was available was a matter for the Member State court.[61]

III. Agency in the EU: Competition Issues

It has long been the position that where an agent agreed to negotiate or conclude contracts on the principal's behalf in his own or the principal's name, the agreement would not infringe Article 101.

The VBER Guidelines[62] confirm that the determining factor is the financial or commercial risk borne by the agent in relation to the contract activities: those directly related to the contracts entered into by the agent for the principal, and those associated with investment for entry to the market—usually "sunk" costs. When the agent bears no such risks, or insignificant risks, its activities are not economically distinct from the principal's, and Article 101 does not apply.

Case law[63] reaffirms that only those resellers that do not assume financial or commercial risks linked to the sale of the products, or assume only a negligible share, will be regarded as "genuine" agents for the purposes of escaping the application of Article 101.

In the *DaimlerChrysler* case,[64] the European Commission found that Mercedes-Benz agents bore a considerable price risk since price concessions were deducted from their commission and that the agents bore risks regarding: (i) transport costs for the delivery of cars; (ii) purchasing demonstration vehicles from Mercedes-Benz; and (iii) carrying out repairs under the sales guarantee.

The ECJ held that the Commission had failed to analyze properly the scope of these risks and their likely impact on agents' behavior. There was no real price risk, since agents were under no obligation to make price concessions. The risk of transport costs was also low since many customers collected from the factory. Similarly, the risk surrounding demonstration vehicles was low since these vehicles could be sold only by agents. The European Commission had also exaggerated the risks regarding the requirement to carry out repairs, since costs were covered by Mercedes-Benz. Consequently, the ECJ quashed the European Commission's €47 million fine.

If an agency agreement lies outside Article 101, all clauses which are an inherent part of the agency agreement in relation to the goods are free from scrutiny. The principal may legitimately restrict the customers to whom or territory in which the agent sells the goods, and also

dictate the price and conditions for sale through the agent.

The agent may also be protected from the activities of other agents in his territory or in respect of its customers (*i.e.*, exclusive agency). However, the reverse situation, in which the agent is restricted from acting as agent for competitors of the principal, may breach Article 101. Such arrangements risk inhibiting inter-brand competition and are likely to infringe the law if they foreclose the market to other suppliers.

IV. Article 102 TFEU: Abuse of Dominance

Article 102 is concerned with unilateral conduct by firms with market power. It prohibits the abuse by a dominant undertaking (or a number of jointly dominant undertakings) of their market strength.[65]

The first step is to determine whether the company is dominant in the relevant properly defined product and geographic dominance is typically achieved well short of monopoly. The European Commission has published guidelines to assist in the determination of the relevant market.[66]

As a rule of thumb, a market share in excess of forty percent is likely to be considered as an indication of dominance in any substantial part of the European Union.[67] However, a full analysis of other factors, *e.g.*, position of competitors, is usually also necessary. The test of dominance is whether the entity is in a position to behave "to an appreciable extent independently of its competitors, customers and ultimately of its consumers."[68] Market share is the starting point.

Abuse can take many forms: examples in the context of verticals include unjustifiably long term supply agreements, exclusive purchasing and supply, discriminatory pricing,[69] bundling,[70] fidelity pricing resales.[71]

A number of cases have dealt with the exclusivity afforded to suppliers of food and drink products in outlets or in vending machines where they supply such machines.[72] The Commission took into account dominance of the suppliers as well as dependence of retailers in condemning such provisions. In the *Coca Cola* case, the Commission accepted undertakings from Coca Cola Enterprises that they would, save in specific circumstances, refrain from entering into total or partial exclusive dealing arrangements with customers and from granting growth and target rebates.[73] Further, for vending machines in particular, the settlement agreement ensured that equipment exclusivity agreements would not equate to outlet exclusivity. The commitments reduced contract duration, gave customers the option of repayment and termination without penalty, and freed up a certain share of cooler space.

In March 2006, the European Commission fined the Norwegian Tomra Group €24 million for the abuse of dominance in the market for the supply of reverse vending machines (machines which collect used drink containers in return for a deposit) in four E.U. Member States and Norway. Tomra's agreements with retailers granted Tomra the status of the exclusive supplier of such machines and imposed individualized quantitative targets or retroactive rebate schemes, the thresholds of which usually corresponded to the total, or almost total, machine requirements of its customers.

In the pharmaceutical industry, some uncertainty exists as to whether abuse such as discriminatory pricing and refusal to supply may be more easily justified due to the particular characteristics of the pharmaceutical market, where prices are often affected by Member State intervention, such as through price control and subsidies, and not simply determined by market forces. A judgment of the ECJ providing guidance to the Greek courts in *Sot Lelos Kia Sia E.E & Others v. GlaxoSmithKline AEVE*[74] offers some further guidance on the application of E.U. competition rules in relation to parallel imports. GSK held marketing authorizations for a number of prescription drugs in Greece and ceased supply to wholesalers in Greece to prevent export into other Member States. GSK continued to market the drugs itself within Greece. GSK later resumed supply to the wholesalers, but in limited quantities. The ECJ held that a dominant undertaking cannot cease to honor the ordinary orders of an existing customer for the sole reason that the purchaser wishes to export the products for resale where prices are higher. It was for the court to determine whether orders are ordinary in the light of the previous pattern of orders. Furthermore, it held that where a dominant undertaking wishes to counter the threat to its commercial interests, it must do so in a proportionate and reasonable way.

The *Intel* case saw the European Commission impose even larger fines—€1.06 billion.[75] Intel was found to have breached Article 102 by giving rebates which were conditional on manufacturers buying all, or almost all, of their requirements for x86 central processing limits from Intel (to the detriment of AMD). Intel also made direct payments to halt or delay the launch of competing products, and Intel sought to conceal these restrictions—most were unwritten and based on oral agreements. The decision and the European Commission's approach were controversial. Intel appealed the decision, unsuccessfully.[76]

Member States are not permitted to ban anything which E.U. law exempts. However, prohibitions of unilateral conduct, which includes abuse of dominance, can be stricter than E.U. rules. Accordingly, many Member States also prohibit abuse of "economic dependence." In the *ATA* case,[77] the French Competition Council examined whether a supplier of taxi meters had abused an economic state of dependence in breach of domestic French law. The Council found, however, that the fact that a distributor carries out a significant, or even exclusive, share of its provision-

ing with one supplier is not enough to characterise such economic dependence, if it has a possibility of substituting its supplier(s) under comparable conditions.

In December 2008, the European Commission published its guidance paper[78] setting out the principles it will follow in applying the abuse of dominance rules to exclusionary conduct by dominant companies. The paper outlines the European Commission's enforcement priorities in regard to a range of abuses.

V. Distribution: Termination Issues

On termination of any distributorship or agency arrangement, the consequences will be determined principally by the terms of the contract between them, but may also be affected by mandatory rules of law, such as competition laws or laws protecting the intermediary.

A. The Use of E.U. Competition Rules in Distribution Disputes

Where termination can be linked to a desire on the part of the supplier to punish the distributor for failure to adhere to pricing policies of the supplier, a damages action can be available in national courts, based on competition law. Threats to terminate may precede actual termination and, at that stage, a distributor may seek to pre-empt the inevitable with an injunctive or declaratory action. Equally, it may threaten to complain to a competition authority. Care must be taken by suppliers considering taking action against the pricing activities or export related activities of distributors or resellers in the European Union.

The issue as to whether a restriction is "unenforceable but severable" will depend on the circumstances in each case. In *McCabe v. Scottish Courage*,[79] regarding severability from a distribution agreement of a "beer-tie" clause which was argued to be anti-competitive, an English court held that, even if the clause were unlawful, it would not be severable, since it had been instrumental in inducing the supplier to enter into the contract. To sever the clause would have damaged the fundamental nature of the agreement, according to the court.

Calor Gas Ltd v. Express Fuels (Scotland) Ltd.[80] further clarified the use of competition law in distribution disputes. This case concerned the enforceability of two clauses. The first was an exclusivity clause, binding the dealer to Calor for the duration of the agreement. The second was a post-termination restriction, preventing dealers from handling Calor's gas cylinders post-termination. The court held that, together, the two clauses infringed E.U. competition law: neither could be enforced and that the combined anti-competitive effect meant that neither clause could be severed.

The Dutch Court of Appeal, Arnhem, held that termination by a furniture producer of a discounting dealership in response to pressure from other dealers was not lawful termination.

As with any contract termination, the consequences depend on the facts, but in Europe it is worth bearing in mind national laws that protect various types of intermediary: failure to do so can be costly.

Commercial agents in Europe, particularly those negotiating the sale of goods for principals, receive significant protection from laws that regulate their rights to receive a compensatory payment from the principal on termination.[81] This type of protection is not generally available to distributors, although the laws of individual Member States differ on this issue and should be borne in mind. The position of distributors will briefly be considered in this Part V, before considering agents in more depth below.

B. Compensation Upon Termination of Distributor

The obligation to compensate or indemnify on termination or to pay damages can arise, of course, out of the contract (failure to terminate according to the terms of the contract, failure to give notice, no reasonable grounds for termination, etc). As stated above, E.U. law provides no particular basis for distributors to claim compensation on termination. However, such claims may arise out of national laws of relevant States. German law provides an interesting example. A German law of 1953[82] was the model for the EC Directive on Self Employed Commercial Agents. There is no specific protection in German legislation for distributors. However, the rationale for compensating agents has been applied to certain supplier-distributor relationships.[83] The courts will examine whether the specific situation of the person/legal entity which has been terminated resembles the position of an agent. If it does, compensation may be awarded. In general terms, the more a distributor is integrated into the sales organization of a supplier the more likely it will be that courts will decide that compensation must be paid. Integration is likely to be established where there is control or influence exercised over marketing, pricing (insofar as legal under antitrust laws), minimum sales requirements, and other similar control mechanisms.

Otherwise, distributors in the United Kingdom are entitled only to contractual compensation based on contractual rights. There is no special protection. Due notice, in the absence of express provisions, will be reasonable notice. What is reasonable will be inferred from the particular circumstances, *e.g.*, the duration of the agreement and the investment made by the distributor in expectation of continuing trading in the goods.[84]

VI. Agency: Extensive Protection in the European Union

Commercial agents may enjoy extensive rights and protections in Europe, a factor to bear in mind prior to an

appointment decision and certainly prior to issuing a termination letter.

A. The Essence of Agency

The legal consequences of an agent's actions are governed by national laws and legal responsibility can also, at least to some extent, be shared between the agent and the principal in the contract. In the United Kingdom, an agent who does not disclose its role as such in negotiations with a customer may be sued alongside the principal. In Germany, the agent is solely liable.

It should also be noted that there are different "types" of agents in the laws of different Member States. Broadly, the "*commissionaire*" model, used in France, Germany and Italy, entails that agents will conclude contracts in their own name and the principal remains undisclosed, so that there is no relationship between customer and principal. Under the "*del credere*" model, the agent indemnifies the principal for the customer's non-payment. Finally, in other jurisdictions, agents are treated essentially as employees.

B. The Commercial Agents Directive

If one distributes goods in the EEA through agents, or indeed through any intermediation by a third party, one should note the potential impact of agency law. The Commercial Agents Directive (86/653/EEC) sets out a number of significant rights for commercial agents charged on a continuing basis with negotiating contracts for the supply of goods (not services—although the protections extend to services in some Member States). The rights to compensation or indemnity on termination are by far the most contentious of the rights granted by this legislation, but other rights such as minimum notice, rights to information, and entitlement to commission on all sales arising from an exclusive territory should be noted.

The Directive has been implemented in all Member States, and similar legislation has been adopted in EFTA States and in other European countries.

The Directive applies to self-employed commercial agents, who can be individuals or corporations.

Member States are obliged to introduce protections that were already available in a number of European States. The principal protections are:

- Minimum notice.
- Rights to a written agreement.
- Rules on entitlement to commission.
- Rules on due date for payment of commission.
- Rules for removal of customers or parts of a territory.
- Rights to relevant documentation / information.
- Rights to commission after termination in respect of transactions generated by the agent.
- Rules as to when the right to commission can be extinguished (and when it cannot).
- Rights to be indemnified or compensated on termination.

C. Scope of the Directive: U.K. Case Law

In the United Kingdom, the Directive is implemented through the Commercial Agents (Council Directive) Regulations 1993. In *PJ Pipe & Valve*,[85] the English High Court interpreted the word "negotiation" widely for the purpose of determining a trader's status as an agent under the Regulations.

Regulation 2 of the U.K. Regulations, which implemented the Directive, provides that by definition an agent must have "continuing authority to negotiate the sale or purchase of goods on behalf of the principal." This definition is taken from Article 1.2 of the Directive. Under the agreements, the agent did not have the authority to vary prices or other terms when negotiating, nor to conclude contracts on the principal's behalf. The agent had, however, a significant role in creating connections between the principal and its buyers and promoting its products, thereby creating significant goodwill. A restrictive interpretation of the word "negotiate" was inappropriate, since it would lead to the exclusion from the protection afforded by the Regulations of commercial agents who created valuable goodwill for their principals. It concluded that the agent was covered by the Regulations.

In 2006, the ECJ also looked at the issue of whether an agent has "continuing authority" (as required by Regulation 2(1) of the 1993 Regulations).[86] It confirmed that the fact an agent is authorised to, and does, conclude "a number of transactions" for the principal is "normally an indicator of continuing authority." An agent who is only authorized to conclude a single contract will not have "continuing authority," unless the agent is authorized to negotiate successive extensions to that contract.

D. Indemnity or Compensation?

This concept is intended to reward an agent in the circumstances of termination where the principal will continue to benefit from the customer base which the agent has built up, whereas the agent would expect to cease to benefit from that customer base. On the contrary, the agent would have to start over again with a new principal/product.

The concepts "indemnity" and "compensation" are slightly different. Compensation is for damage on termination, irrespective of contractual damages. The agent is entitled to be compensated for deemed damage, and damage is deemed to have occurred where termination takes place in circumstances that deprive the agent of commissions which proper continuing performance of the

agency contract would have provided, while the principal continues to enjoy substantial benefits attributable to the agent's activities. Further, an agent is entitled to compensation where termination prevents the agent amortizing costs and expenses incurred in performing the agency contract on the principal's advice.

Indemnity, on the other hand, is due where the agent has brought new customers or increased the volume of business with existing customers and the principal continues to derive substantial benefits and where payment is found to be equitable in all the circumstances.

1. Indemnity

In regard to most European States, you need to determine whether the regime provides for indemnity or compensation or whether, as in the United Kingdom, a choice can be made.

Guidance on these concepts can be obtained from case law of the ECJ and national courts. The Regulations cannot be defeated by a choice of non-E.U. law. In *Ingmar v. Eaton Leonard Technologies*,[87] the agent was active in the United Kingdom but the parties had chosen the law of California (where the principal was based) to govern the contract. The ECJ held that the mandatory provisions of E.U. law, which are given effect by the Regulations, could not be evaded "by the simple expedient of a choice-of-law clause." In *Accentuate v. Asigra*,[88] the English High Court held it had jurisdiction to hear a claim for compensation under the Agency Regulations, even though the relevant agreement was subject to a choice of Canadian law and arbitration and the Canadian arbitral tribunal had already ruled against the claim.

Indemnity has the advantage, from the principal's point of view, of being capped at one year's commission averaged over the preceding five years or, if less, the duration of the agreement.

Agents typically receive commission during the contract. This does not generally reflect the value of the goodwill generated for the principal, which then provides no benefit to the agent post-termination. This is the commercial justification for the payment of a goodwill indemnity, which represents the continuing benefits to the principal due to the efforts of the agent. If no goodwill has been generated by the agent (*i.e.*, the agent has generated no new customers or increased business with existing customers), no indemnity need be paid.

2. Compensation

The compensation system was based on French law dating from 1958. Its aim was to compensate the agent for the loss suffered as a result of the termination of the agency agreement. A body of case law has developed in France concerning the right level of compensation under the national law. Justification for compensation has included that which represents the cost of the agent's successor of purchasing the agency; or represents the time it takes for the agent to re-constitute the client base of which the agent is forcefully deprived.

Courts in the United Kingdom will not slavishly follow the French tariff approach.[89] The U.K. courts have in the past taken account of duration and history of the agency. However, two cases[90] have confirmed that the correct approach will be to value compensation against the market reality of the worth of the agency, assuming it were to be sold and the likelihood of what a potential buyer might have been willing to offer. In the United Kingdom the attribution of market value to an agency is likely to be a hypothetical calculation, but it was quite possible that a hypothetical purchaser would not have been prepared to pay any price for the agency business. This might be the case where an agency business was terminally in decline.

Several cases illustrate that it is difficult to game the amount that might be paid on termination. Agreements can specify that compensation/indemnity will be calculated on the basis of different criteria to those in the Commercial Agents Directive only if it is absolutely certain at the time of making the agreement that it will be applied in every individual case where the agreement is applied to provide indemnity/compensation equal to or better than what the agent would receive under the Directive. In one case, a clause which provided the agent was entitled either to compensation or indemnity, whichever produced the lower sum, was ruled invalid, leaving the agent entitled to compensation which, in United Kingdom law, is the default in the absence of an agreed choice. In another case, an agreement which contained a "compensation-or-indemnity whichever-lower" clause also contained a severance clause. In that case, the court excised compensation, leaving indemnity as the applicable concept.

E. Reasons for Termination

The Directive provides[91] that the compensation (which includes indemnity for this purpose) is not payable to the agent where the agreement is validly terminated for breach (unless it is the principal who is in breach) or when the agent, with consent of the principal, assigns its rights and duties under the contract to another person.

Therefore, if a sufficiently material or fundamental breach of the agency contract can be established which would entitle the principal to terminate according to the contract law rules applicable to the obligation in question, then the agent's rights to compensation/indemnity are lost. In *Fryer*,[92] the breach by which the agent was held to have repudiated the contract was a minor but persistent breach (non-provision of weekly reports where there had been a number of formal warnings).

It is therefore important to consider adequate specification of fundamental contractual provisions and the laws applicable to them. Failure to meet targets may be insuf-

ficient if the principal was to blame. In the French *Cour de Cassation*, it was held that the burden of proof was on the principal to prove the agent was in breach where the agent blames economic stagnation, price increases or competition from the principal for failure to reach results.[93] If an agent takes clients with him, that may affect the compensation payable.[94] The English courts will allow a claim for compensation/indemnity to "top up" any common law claim of damages for breach of contract.[95]

VII. Trademarks and Parallel Trade in the European Union

For a long time it has been established that, within the European Union, the placing on the market in a Member State of a product exhausts the trademark right of the right owner, so trademark rights could not be used to prevent the flow of goods from one Member State to another.

The issue of international exhaustion on the other hand was considered by the ECJ in the joint cases of *Levi Strauss v. Tesco* and *Zino Davidoff v. A&G Imports.*[96] The result was good for brand owners, but was a major setback for parallel importers. Tesco, and various other retailers, had for several years been of the opinion that they should legally be entitled to purchase designer goods from outside Europe and import and sell them in Europe without entering into an arrangement with the brand owners. The brand owners disputed this and this finally resulted in court proceedings being initiated in the above mentioned cases.

Where goods have been placed on the market outside the EEA there is no international exhaustion. In the *Levi Strauss* and *Davidoff* cases, the parallel importers argued that, although they did not have the brand owner's express consent to import the goods from outside the EEA and sell them inside the EEA, the brand owners had implicitly consented. This implied consent arose from the fact that the brand owners had not imposed restrictions on what was to happen to the goods at every stage of the supply chain.

The ECJ held that if the express consent of the trade mark owner has not been obtained, then it can be implied only if certain conditions are satisfied.

- The "implied" consent must be positive, *i.e.*, it cannot be inferred from silence.
- The trademark holder must be shown to have unequivocally demonstrated its intention to renounce its rights to object to the marketing of the goods in the EEA.
- The burden of proof that consent has been given lies on the person alleging it and not the brand owner.

The U.K. courts have examined the application of these principles in several cases, including *MasterCigars* and *Honda Motor Co*.[97]

In the *MasterCigars* case, the issue was whether *MasterCigars* was permitted to sell branded cigars in the United Kingdom which it had bought in Cuba from a local agent of the Cuban cigar manufacturer, Corporacion Habanos SA (Habanos). The background was that, although Habanos was, in principle, the only company registered to export its cigars from Cuba, it permitted exports of up to US$25,000, which could be bought from official outlets by overseas visitors to Cuba. MasterCigars duly bought a number of consignments in Cuba on this basis and imported them into the United Kingdom. Habanos claimed that this infringed its trademark and that it had not consented to such imports. The Court of Appeal rejected this argument and found that Habanos had implicitly consented to sales in the United Kingdom. The main factors which led to the finding of implied consent by Habanos were the fact that:

— The official outlets and Habanos were economically linked because Cuba was a socialist country and Habanos had a degree of control over such outlets (unlike the situation in *Davidoff*, Habanos therefore knew what its resellers were doing);

— Habanos must have known that sales of up to US$25,000 would be used for commercial purposes abroad and not just for personal consumption; and

— the invoices which agents provided to purchasers, giving Customs clearance, clearly permitted exports from Cuba without providing for any limitation on future sales.

A system had therefore been set up to allow for exports outside Cuba. Since Habanos had not made any attempt to police the exports (and indeed was fully aware of them) it had unequivocally consented to sales in the United Kingdom.

In *Honda Motor Co*., the parallel imports issue arose as a result of KJM importing Honda motorbikes into the United Kingdom that it had purchased from an Australian exporter, Lime Exports, which had in turn purchased from Honda. Honda claimed that this was trademark infringement. However, the High Court found that Honda had by implication consented to such sales, since Honda had a long-standing relationship with Lime Exports and was fully aware that Lime Exports was selling motorbikes to non-Australian customers. The act of selling the motorbikes to Lime Exports without attaching any conditions could therefore only be interpreted as granting unequivocal consent to sell in the United Kingdom.

These cases demonstrate that the concept of implied consent mentioned in *Davidoff* is not merely a theoretical one. At least in the United Kingdom, courts may find

implied consent in situations where a trademark owner has not set up its distribution system in such a way as to make it clear that sales to the European Union are prohibited. In particular, where the trademark owner is aware of (or is turning a blind eye to) the fact that its resellers are making sales into the European Union, it may be difficult for it to claim that it has not consented.

In practice, however, the types of problems which arose in *MasterCigars* and *Honda Motor Co*. can be avoided. In both these cases the court accepted that a clear prohibition against resale in the European Union or even the right to monitor the destination of sales (backed up with action where the destination is contrary to that intended), would be regarded as withdrawal of consent.

Another case which highlights the effect that the distribution system can have on a rights holder's ability to enforce its rights is that of *Oracle v. M-Tech*.[98] Oracle (formerly known as Sun Microsystems) manufactured "Sun" branded computer hardware, and M-Tech was a U.K.-based independent reseller of computer goods. Oracle distributed its goods in the EEA and outside the EEA under licenses exclusive to each territory.

M-Tech purchased second-hand Sun-branded hardware products from a U.S. dealer and resold them in the United Kingdom. Oracle alleged this constituted an infringement of its trademark rights, since it had not consented to the resale. On hearing Oracle's application for summary judgment in the U.K. High Court, Justice Kitchin held that the products in question had been first put on the market in China, Chile and the United States, and thus Oracle was entitled to rely on its trademark rights which had not been exhausted. Oracle was awarded summary judgment in its favor.

However, M-Tech's appeal against the order was subsequently granted by the U.K. Court of Appeal. On the basis that M-Tech had a real prospect of establishing a defense based on the fact enforcement of the trademarks would have the effect of partitioning the EEA market contrary to free movement rules in the TFEU Articles 34-36 and that the agreements Oracle had with its authorized distributors were anti-competitive, Oracle appealed to the Supreme Court.[99] Oracle's appeal was successful. The Supreme Court confirmed that the E.U. trademark rules should be regarded as the definitive statement of the harmonized law in this respect. There was no inconsistency between the Trademark Directive and the TFEU. The right to control the first marketing of goods in the EEA did not engage the principle of free movement of goods, since it affected only the entry of goods into the EEA market, not the movement of the goods within it. Even if Oracle was engaging in other activities which were contrary to the free movement rules, this did not prevent Oracle from legitimately enforcing its trademark rights in respect of goods not previously marked in the EEA.

The Supreme Court has come down firmly on the side of brand owners and confirms that trademarks can be used to prevent unauthorized resale within the EEA of goods purchased outside the EEA. Brand owners should still be careful to avoid giving implied consent to resale, but, provided it is clear importation into the EU is not permitted, the balance of power should still rest with the trademark owner.

Finally, it is worth mentioning the ECJ's judgment in *Copad SA v. Christian Dior couture SA and others*,[100] which considered the enforcement of trademark rights against a licensee who was selling goods, corsets, to a discount retailer in breach of the license. The licensee argued that the trademark rights were exhausted by the licensee's sales. The case turns on the interpretation of the E.U. Trademark Directive (which sets out in detail the principles of exhaustion), but essentially provides that trademark rights can be asserted where the licensee's violation of the licence could damage quality of the goods which includes "the allure and prestigious usage which bestows on those goods an aura of luxury." In those circumstances, the licensee is not acting with the owner's consent and the trademark rights are not exhausted. In this case the trademark owner had set up a selective distribution agreement which contributed to the reputation of the goods and sustained the aura of luxury around them. Whether trademark rights can be relied upon in this way will depend on the facts of each case.

VIII. Conclusion

Distribution in the European Union can be commercially attractive but there are risks. Irrespective of whether one's agreements are drafted to avoid the obvious pitfalls on territory, on-line sales, and resale pricing, one cannot avoid the temptation for country managers to threaten cutting off supplies for what they see as unhelpful distribution practices—but which the law mandates should be permitted. These risks can be dealt with only by pervasive compliance and alert intervention.

Endnotes

1. Most attorneys will be aware that the existence of and approach to client-attorney privilege differs between E.U. States and again differ from E.U. proceedings. For lawyer-client communications to enjoy privilege in E.U. antitrust proceedings, the lawyer must be "independent," *i.e.*, not employed by the client and admitted to the European bar. In-house lawyers' communications do not enjoy privilege in such proceedings in direct contrast with, for example, U.K. competition law proceedings.
2. Following the entry into force of the Lisbon Treaty on 1 December 2009. As to terminology, the term "European Community" has been replaced by "European Union" and "Common Market" by "Internal Market." The Court of Justice of the European Union comprises the Court and the General Court, formerly called the Court of First Instance. For simplicity, the references in the text will refer to "ECJ." The majority of the members of the European Free Trade Association and all E.U. Member States are also party to the European Economic Area Agreement. Together they constitute

EEA, where most competition law and free movement rules are the same.

3. *See, e.g.*, T-325/01, *DaimlerChrysler AG v. Commission*, [2005] ECR II-331, in which the ECJ partially upheld the Commission's decision that the car maker unlawfully had agreed with its distributors on various measures to prevent parallel trade between Member States. *See also* the Commission's JCB decision (COMP/35.918 [2000] OJ L069/1), largely upheld on appeal to the ECJ (cases T-67/01 and C-167/04); JCB was fined €30 million for agreeing with its distributors to partition the market. In 2002, Nintendo was fined €168 million, and its distributors were also fined, for agreeing to prevent parallel trade. COMP/35.587 [2002] OJ L255/33.

4. *See, e.g.*, Commission Decision COMP/36.516, *Nathan Bricolux*, [2001] OJ L54/1 and Commission Decision COMP/36.693, *Volkswagen*, [2001] OJ L 262/14. Note, however, that the *Volkswagen* decision was overturned on appeal to the ECJ in T-208/01 and case C-74/04, since the Commission had failed to show the existence of an agreement between VW and its distributors.

5. *See, e.g.*, the Commission's decision in *B&W Loudspeakers* (discussed below) and judgment of ECJ in case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS Président de l'Autorité de la Concurrence and others*, [2011] ECR I-9419.

6. *E.g.*, Commission Decision COMP/38.348, *Repsol*, [2006] OJ L 176/104, the Commission accepted commitments from a Spanish petrol supplier to free service stations from long-term exclusive supply agreements.

7. *E.g.*, Commission Decision IV/35.079, *Whitbread*, [1999] OJ L88/26, regarding "beer ties." *But see* Case C-234/89, *Delimitis v. Henninger Bräu*, [1991] ECR I-935.

8. CC Report Private Motor Insurance. Germany's Competition Authority ordered Booking.com not to impose most favored nation clauses on hotels preventing them from undercutting on their own websites. *But see* Case 11V96/14(Kart), where a German court upheld a ban on dealers selling on online channels such as Amazon.

9. Case C67/13 P, *Groupement des cartes Bancaires v. European Commission*, [2014] 5 C.M.L.R. 22. *See also* Case C-226/11, *Expedia Inc v. Autorité de la concurrence and others Inc*, [2013] 4 C.M.L.R. 14.

10. C-15/74, *Centrafarm BV v. Sterling*, [1974] ECR 1147.

11. T-102-92, *Viho v. Commission*, [1997] 4 CMLR 469, *upheld by the ECJ* in C-73/95, *Viho v. Commission*, [1996] ECR I-5457.

12. *DaimlerChrysler AG*, [2005] ECR II-331.

13. Commission Decision COMP/39.847, *E-Books—Summary of Commission Decision of 12 December 2012*, relating to a proceeding under Article 101 of the TFEU, OJ C73, 13 March 2013, at 17-20.

14. Guidelines on the effect on trade concept, OJ [2004] C101/81.

15. C-5/69, *Völk v. Vervaecke*, [1969] ECR 295.

16. Notice on agreements of minor importance (De Minimis Notice), OJ [2014] C 291/01.

17. *Expedia Inc.*, note 9 *supra*, [2013] 4 C.M.L.R. 14.

18. Case C-67/13 P, *Groupement des Cartes Bancaires v. Commission*, [2014] 5 C.M.L.R. 22; Case C-345/14, *SIA 'Maxima Latvija' v. Konkurences padome*, [2015] Bus. L.R. 1565.

19. Guidance on restrictions of competition "by object" for the purpose of defining which agreements may benefit from the De Minimis Notice, C(2014) 4136 final.

20. Case 114/85, *A Ahlstrom Oy v. Commission*, [1988] ECR 5913 (Re the *Woodpulp* cartel case).

21. Case C-306/96, [1998] ECR I-1983.

22. The maximum fine under U.K. competition law is the same as under E.U. law (*i.e.*, ten percent of annual worldwide turnover). The Dutch authorities' fining powers will increase in 2016 to a maximum forty percent of turnover.

23. UK Consumer Rights Act 2015, which has introduced a form of collective action for damages on an opt-out basis; Directive 2014/104/EU on antitrust damages actions.

24. Broadly, that exempts agreements which do not involve parties with high market shares and which contain acceptable restraints. Where an agreement does not meet the conditions of the block exemption that does not mean it is prohibited, simply that it is necessary to assess whether it justifies being exempted against the criteria in Article 101(3) on its individual merits.

25. Regulation 330/2010, [2010] OJ L 102/1, on the application of TFEU Article 101(3) to categories of vertical agreements and concerted practices.

26. *See* Regulation 316/2014 on the application of Article 10(3) to categories of technology transfer agreements.

27. Article 5.

28. Article 4.

29. Article 1(d).

30. Article 5(1)(a).

31. Article 5(c).

32. *Leegin Creative Leather Products, Inc v. PSKS, Inc.*, 55/US,877 (2007).

33. *See, e.g.*, Agreement between Irish Competition Authority and Double Bay Enterprises Limited (a distribution of the FitFlop brand) not to engage in RPM and associated Court Order (2012 No4 CMP).

34. Commission Decision COMP/36.693, [2001] OJ L 262/14, *overturned by the ECJ in case* T-208/01, *Volkswagen AG v. Commission of the European Communities*, [2003] ECR II-5141, on the issue of proof of dealers' acquiescence, *upheld on appeal*, C-74/04, *Commission v. Volkswagen AG*, [2006] ECR I-6585.

35. This was one of the pricing infringements for which retailers and tobacco manufacturers were fined £225m by the U.K. Office of Fair Trading in April 2010, although the case collapsed when challenged as witness evidence did not support the allegations.

36. What constitutes threats or pressure will vary from one E.U. Member State to another. In Germany, any contact with the retailer after notifying a recommended price will be liable to be taken to amount to pressure.

37. *See* Case C-59/08, *Copad SA v. Christian Dior SA*, [2009] ECR I-3421.

38. *See* Commission Decisions COMP/38.085 of 17 February 2005 and COMP/38.307 of 10 June 2005, which found that Gazprom's gas supply contracts with its Austrian and German distributor infringed competition law as they prohibited resales outside Austria and Germany.

39. *See, e.g.*, Commission Decision COMP/37.275 of 5 October 2005, where Peugeot was fined €49.5 million for preventing exports of new cars from the Netherlands by making remuneration of its distributors conditional on the destination of the vehicles.

40. *Double Bay Enterprises Ltd* involved restrictions on passive sales (by requiring retailers to resell only within their allocated territories).

41. 2010 Guidelines on Vertical Restraints, paras 61-62. *See Distillers Company plc (Red Label)*, OJ 1983 C 245/3.

42. Selective distribution networks can in principle be set up in relation to any goods, but it will be harder to prove efficiency gains other than marginal ones in relation to "normal" products. The Commission indicates that it is unlikely that such gains will outweigh the reduction in price competition.

43. One case confirmed that suppliers operating a quantitative selective distribution system (as opposed to one open to all distributors provided quality criteria are satisfied) need not publish its entry criteria and such criteria need not be objectively justified or related to quality issues. It is sufficient that they are

verifiable (Case C-158/11 Auto 24, *SARL v. Jaguar Land Rover Finance SAS*, [2012] 5 C.M.L.R. 3. This means that dealers can be refused entry to such systems with relative ease, provided market share thresholds are met.

44. *See, e.g.*, Commission Decision in respect of *Pittsburgh Corning Europe*, OJ [1972] L272/35 (differential prices according to territory to prevent parallel imports); Commission Decision in respect of *Kodak*, OJ [1970] L147/24 (orders from outside the territory to be charged at the price in the territory where the order originated, not where order received); Case 30/78, *Distillers Co Ltd v. Commission of the European Communities*, [1980] ECR 2229; Commission Decision *GlaxoSmithKline*, OJ [2001] L302/1, where the Commission declined to grant an individual exemption to a dual pricing policy.

45. Case T-168/01, *GlaxoSmithKline Services Unltd v. Commission of the European Communities*, [2006] ECR II-2969.

46. *See* para 25 of the Guidelines on Vertical Restraints for discussion of acquiescence and the distinction between unilateral conduct and deemed consensus.

47. In Case 27/76, *United Brands v. Commission*, [1978] ECR 207, and Case T-83/91, *Tetra-Pak International SA v. Commission*, [1994] ECR II-755, geographic price discrimination was found to be an abuse of dominance.

48. Paragraph 177, Case T-168/01, *GlaxoSmithKline Services Unlimited v. Commission*, [2006] ECR II-2969 (although these observations were *obiter* as the case concerned Article 101).

49. Investigations involving MFN clauses was undertaken by the European Commission against six Hollywood studios in relation to contracts with European pay-TV companies. It was closed in 2004 after the MFN clauses (which ensure that if better terms were agreed between a pay-TV company and one studio, similar terms must be offered to the other studios) were withdrawn or waived by the studios.

50. *See, e.g.*, COMP/39847, European Commission investigation into e-books; OFT investigation into online hotel booking (it is looking at price parity clauses imposed by online hotel booking sites, including Expedia, Booking.com and Priceline, which prevent partner hotels from offering lower prices to other websites); *Bundeskartellamt* investigation into Amazon Marketplace price parity clause (which prevents sellers from offering their products at a lower price elsewhere).

51. In the e-books investigation against Apple and a number of publishers, the European Commission suspected that the parties had colluded to raise retail prices for e-books. The retail MFC clause in agency agreements between Apple and the publishers acted as a joint "commitment device," which ensured that the publishers would have the same financial incentives to make Amazon and other retailers switch to the agency model during the same time period (since otherwise the publishers would have to offer Apple any lower prices offered by other retailers). The MFC meant that if Amazon offered a lower price the publishers were obliged to allow Apple to match it.

52. The Private Motor Insurance Market Investigation Order 2015.

53. Commission Guidelines on Vertical Restraints, paras 54-58.

54. *See also* Commission Decision, *Yves Saint Laurent Parfums*, 92/33/EEC, [1992] OJ L12/24; Commission Decision COMP/37.709, *B&W Loudspeakers*; and Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS Président de l'Autorité de la Concurrence and others*, [2011] ECR I-9419.

55. [1992] OJ L12/24.

56. Case T-19/92, *Groupement d'Achat Edouard Leclerc v. Commission*, [1996] ECR II-1851.

57. Commission Press Release IP/01/713 of 17 May 2001: http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/01/713|0|RAPID&lg=EN.

58. *Tribunal de Commerce*, Pontoise, 15 April 1999.

59. The selective distribution agreement stipulated that sales of the relevant cosmetic and personal care products must be made in a physical space and that a qualified pharmacist must be present.

60. *Conseil de la Concurrence*, Decision 08-D-25 of 29 October 2008.

61. The French *Cour d'Appel* ruled that the internet ban did not benefit from an individual exemption and the original fine was upheld.

62. 2010 Guidelines on Vertical Restraints, paras 12 to 21.

63. *See* the *DaimlerChrysler* case discussed below, note 64 *infra*, and Case C-279/06, *CEPSA Estaciones de Servicio SA v. LV Tobar e Hijos SL*, [2008] ECR I-6681.

64. Case T-325/01, *DaimlerChrysler AG v. Commission*, [2005] ECR II-3319.

65. "Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between member States. Such abuse may, in particular, consist of:
    - directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
    - limiting production, markets or technical development to the prejudice of consumers;
    - applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and
    - making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

66. *See* European Commission Notice on the definition of the relevant market for the purposes of Community competition law at http://europa.eu.int/comm/competition/antitrust/relevma_en.html.

67. There have, however, been cases in which market shares of less than forty percent have nevertheless been found to be dominant. For example, the Commission found British Airways to be dominant with a market share of 39.7%. Furthermore, in C-250/92, *Gøttrup-Klim e.a. Grovvareforeninger v. Dansk Landbrugs Grovvareselskab AmbA*, [1994] ECR I-5641, the ECJ ruled that market share of thirty-two percent may be held to be dominant, dependent upon the strength and number of its competitors.

68. C-27/76, *United Brands v. Commission*, [1978] ECR 207.

69. *See, e.g.*, C-497/99P, *Irish Sugar plc v. Commission*, [2001] ECR I-5333.

70. *See, e.g.*, Commission Decision COMP/37.792, *Microsoft*, [2004] OJ L166/20.

71. *See, e.g.*, Case T-203/01, *Michelin v. Commission*, [2003] ECR II-4071.

72. Case T-7/93, *Langnese Iglo GmbH v. Commission of the European Communities*, [1995] ECR II-1533; and Case T-65/98, *Van den Bergh Foods Ltd v. Commission of the European Communities*, [2003] ECR II-4653.

73. Commission Decision COMP/39.116, *Coca-Cola Company*, [2005] OJ L253/21.

74. C468/06, [2008] ECR I-7139.

75. Commission Decision COMP/37.990, *Intel*, [2009] OJ C227/13.

76. Case T-286/09, *Intel Corp v. European Commission*, [2014] 5 C.M.L.R. 9.

77. *Conseil de la concurrence*, 28 July 2005.

78. Available at: http://ec.europa.eu/competition/antitrust/art82/index.html.

79. *James E McCabe Ltd v. Scottish Courage Ltd*, [2006] EWHC 538 Comm, judgment of 28 March 2006.

80. 2008 S.L.T. 123.

81. Council Directive 86/653/EEC on the coordination of the laws of Member States relating to self-employed commercial agents.
82. German Commercial Code Section 89b.
83. Case BGHZ 29, at 83.
84. *See, e.g.*, *Decro-Wall International SA v. Practitioners in Marketing*, 1971 2 All ER 216, where twelve months was reasonable given five years' duration and the level of expenditure. *See also Automatic Systems S.A. v. Methon B.V.*, Amsterdam Court of Appeal on 6 April 2010, LJN:BM2020, where the Court decided that, given the circumstances of the case, a notice period of three years was to be considered a reasonable term of notice for the termination of a distribution agreement which has existed for thirty years. In *Jackson Distribution v. Tum. Yeto Inc*, [2009] EWHC 982, the distributor had invested heavily in the early years (two years six months) and it would take time to find an alternative shoe branch (nine months' notice).
85. *PJ Pipe & Valve Co Ltd v. Audco India Ltd*, [2005] EWHC 1904 (QB).
86. C-3/04, *Poseidon Chartering BV v. Marianne Zeeschip Vof*, [2006] ECR I-2505.
87. [2000] ECR I-9305.
88. *Accentuate v. Asigra*, [2009] EWHC 2655 (QB).
89. *Barrett McKenzie v. Escada (UK) Ltd*, [2001] E.C.C. 50, 1/2/2001.
90. *Lonsdale v. Howard & Hallam Ltd*, [2007] UK HL 32. *Warren (T/A On-Line Cartons and Print) v. Drukkerij Flach B.V.* (2014).
91. Article 18.
92. *Nigel Fryer Joinery Services Ltd v. Ian Firth Hardware Ltd*, [2008] EWHC 767.
93. *Acodin Sarl v. Etablissements Rabaud*, [1992] ECC 84.
94. *See* the Dutch case of *Rosa Ronstedt GmbH v. ST Fashions*, [1993] ECC 57.
95. *Duffen v. Fra.Bo SpA (No.2)*, [2000] 1 Lloyd's Rep.180, Court of Appeal 30 April 1998.
96. Joined Cases C-414/99, C-415/99 and C-416/99, [2001] ECR I-8691. In this case the ECJ responded to a reference from the English courts. The *Davidoff* case was subject to proceedings in both England and Scotland jurisdictions and Lord Kingarth in the Scottish Court of Session found in favor of the brand owners without the need for a reference to the ECJ (allegedly due to the Scottish courts' greater experience in hearing such disputes from the likes of whisky distillers).
97. *Corporacion Habanos SA v. MasterCigars Direct Ltd & another*, [2007] EWCA Civ 176, 8 March 2007; Honda Motor Co. Limited (2): *Honda Motor Europe Limited v. KJM Superbikes Limited and others*, [2008] EWHC 338 (Ch), 28 February 2008.
98. *Oracle v. M-Tech*, [2010] EWCA Civ 997.
99. *Oracle America Inc (formerly Sun Microsystems Inc) v. M-Tech Data Ltd*, [2012] UKSC 27.
100. Case C-59/08, [2009] ECR I-3421.

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International Compliance and Privilege Issues Confronting the Oilfield Services Industry

By Brent A. Benoit and Scott L. Friedman

I. Introduction

The oilfield services industry faces a myriad of compliance issues, including anti-corruption legislation, trade controls and economic sanctions, and customs issues. Moreover, emerging issues constantly change the playing field, while a falling commodity price sharpens competition. Lawyers dealing with these issues should be aware of the compliance landscape, as well as the privilege issues that they face when acting in countries around the globe to ensure compliance with governing law (both of the host country and of other mandatory regulations) and internal corporate policies.

II. International Compliance Issues Confronting the Oilfield Services Industry

A. Anti-Corruption Legislation

1. FCPA

The United States enacted the Foreign Corrupt Practices Act ("FCPA") in 1977. The FCPA has a number of effects, including the prohibition of payment of bribes of both public and nonpublic companies.[1] The FCPA also imposes bookkeeping and internal accounting control responsibilities on public companies.[2] The FCPA also imposes SEC civil liability and SEC criminal penalties for violations of its requirements and proscriptions.[3]

The most publicized of the potential violations are those related to bribes. The four elements that constitute an FCPA bribery violation are (i) payment or *attempted* payment to (ii) a foreign official (iii) with corrupt intent (iv) for a business purpose.[4] Exceptions exist for facilitating payments and addressing emergency situations.

FCPA investigations and the penalties imposed for violations are exorbitantly expensive.[5] Even where penalties are not imposed, the cost of the investigations alone are incredible. In 2014, ten companies paid $1.56 billion to resolve FCPA investigations.[6] As an example from the oilfield services industry, the SEC's charges against Weatherford International in 2013 represent one example of FCPA enforcement. Among other allegations, the SEC alleged that "Weatherford and its subsidiaries falsified its books and records to conceal" illicit payments related to obtain U.N. Oil-for-Food contracts as well as "commercial transactions with Cuba, Iran, Syria, and Sudan that violated U.S. sanctions and export control laws."[7] Weatherford agreed to a settlement with the SEC and other U.S. federal agencies exceeding $250 million.[8]

2. U.K. Bribery Act

The United Kingdom's Bribery Act ("UKBA") was enacted in 2010. It criminalizes a variety of conduct, including giving bribes (whether commercial or otherwise), receiving bribes, and bribery of domestic or foreign public officials. Not only does the UKBA criminalize affirmative acts, but it also criminalizes omissions, such as the failure of commercial organizations to prevent bribery.[9] As the above description indicates, there are important differences between the UKBA and FCPA. While the FCPA only addresses the bribery of foreign officials, the UKBA applies to commercial bribery in general. In addition, the UKBA does not exempt facilitation of payments. The UKBA is forgiving, however, to companies that put "adequate procedures" in place to prevent bribery, providing an affirmative defense in appropriate circumstances.

Critics have suggested that while the UKBA rivals the FCPA in form, the SFO, the U.K.'s Serious Fraud Office, overuses civil settlements for corporate cases of foreign bribery instead of imposing criminal sanctions. Despite that criticism, the United Kingdom has reduced the agency's budget from over fifty million Pounds to approximately thirty million Pounds from 2008 through 2015—a forty-percent reduction over seven years.[10]

3. Brazil Clean Company Act

Effective 29 January 2014, Brazil's Clean Company Act places "administrative and civil liability on legal entities engaging in bribery of public officials." Generally, the Clean Company Act "conforms to and, in several respects, even exceeds the requirements of the [OECD] Anti-Bribery Convention."[11]

The BCCA creates both administrative and civil strict liability for foreign or domestic corporations that promise, offer or give (directly or indirectly) any undue advantage to (i) a public servant or (ii) a third person related to him, or that fund efforts to use a third party to do so.[12] The BCCA has a broad scope, reaching any company, as well as any foundation or associate of entities or individuals who are domiciled or have a presence in Brazil, even if that presence is temporary.[13] The law considers any entity with a registered office, branch or other representation in Brazil to be subject to Brazil jurisdiction.[14]

4. Other Countries Adopting Similar Legislation

Of the twenty largest national economies, thirteen of them regulate domestic commercial bribery; of those twenty, only seven regulate foreign commercial bribery. Those seven are the United States (via the Travel Act and

the Books and Records provisions of the FCPA), Germany, the United Kingdom, Russia, Spain, the Netherlands, and Switzerland.[15] More broadly, the 1997 OECD Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions binds forty countries to enact laws to criminalize the bribery of other countries' public officials.[16]

B. Trade Controls and Trade Sanctions

A variety of schemes exist to control international business transactions based upon the identity of the parties, the classification of the item, the country of destination, or the end-use of the product.

1. Economic Sanctions and Embargos

Sanctions are punishments or penalties assigned for violations of the law taken by one country against another to compel it to obey international requirements by limiting or halting trade with that country.[17] Traditionally, sanctions have been applied to only a few "black-listed" countries such as Libya, Iran, Iraq, North Korea, and Cuba. Within recent years, however, sanctions have been expanded by OFAC, Commerce, the State Department, Congress, the White House, or pursuant to U.N. Resolutions to apply to thirty-three countries."[18]

(a) Iran—Recent Developments

Iran and other nations signed an agreement on Iran's nuclear program called the Joint Comprehensive Plan of Action ("JCPOA"), which impacted the sanctions regime against Iran. "The JCPOA will produce the comprehensive lifting of all U.N. Security Council sanctions as well as multilateral and national sanctions related to Iran's nuclear program, including steps on access in areas of trade, technology, finance, and energy."[19] But the lifting of U.S. sanctions is not a total lifting. Non-nuclear U.S. sanctions will remain in place, essentially returning the U.S. to the sanctions regime existing prior to 2012. The JCPOA provides that the United States will permit foreign companies to engage in Iranian commerce, but the contours in which business may be transacted with Iran are unclear. The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") is in the process of developing guidance for interested parties.

Under the pre-JCPOA sanctions regime, OFAC issued a "Finding of Violation" to Schlumberger Oilfield Holdings, Ltd. for violations of Iranian sanctions.[20] The Finding of Violation was based on Schlumberger's knowing and willful violations of (i) systematically approving and disguising capital expenditure requests from operations in Iran and Sudan for the manufacture of new tools and for certain expenditures; (ii) directing and overseeing the transfer of oilfield equipment from projects in non-sanctioned countries to projects in Iran and Sudan; (iii) making and implementing business decisions specifically concerning projects in Iran and Sudan; and (iv) providing certain technical services in order to troubleshoot mechanical failures and to sustain sophisticated oilfield services equipment in Iran and Sudan.[21]

Another recent enforcement action involved Indam International, Inc. Indam settled charges for apparent violations of the U.S. Iranian sanctions for its failure to "conduct due diligence to determine the end users of its products," who turned out to be Iranian.[22]

The lifting of sanctions promises to lead to increased activity among oilfield services companies. "We have a good understanding with Iran about what they would like to do first. The day the sanctions are lifted that's when we can start," said Samir Brikho, chief executive of Amec Foster Wheeler.[23] With those lifted sanctions, however, firms must continue to focus on those U.S. sanctions that will remain in place and avoid running afoul of them.

(b) Cuba—Recent Developments

The Cuban embargo dates back to 1962, following the rise of the Castro government and the island's movement toward communism.[24] The broad sanction prohibited almost all transactions by U.S. persons involving property in which the Cuban government or Cuban nationals have an interest.[25] In August 2015, scores of individuals and companies were deleted from OFAC's "SDN" list as of 27 August 2015.[26] While the U.S. embargo on Cuba remains in place, the Obama White House is likely to continue to "carve out exceptions."[27] With that, relations between the two countries have begun to normalize.

(c) Russia—Recent Developments

Many countries have sanctions in place against Russia, including the United States and the countries of the European Union.[28] For example, the United States has imposed sanctions on Rosneft and Novatek, Russia's second-largest gas producer, over Russia's support for rebels in Ukraine.[29] Schlumberger has described the sanctions as restricting the "engagement of people and equipment" but not causing a "material disruption."[30] The sanctions impact new exports and investments and are not retroactive.[31] "Before the onset of the sanctions, Russia was seen as a growing market for the oil service industry."[32]

Separate and apart from the sanctions against Russia, the Crimea region is subject to multiple sanctions programs. A full economic embargo is in place for all imports from and exports to Crimea of goods, services, or technology.[33] The embargo further extends to shipments to drilling blocks and oil fields within Crimea's jurisdiction.

(d) Sudan

Sudan remains subject to broad U.S. sanctions. Specifically, Executive Order 13412 prohibits all transactions by U.S. persons relating to Sudan's petroleum or petrochemical industries with Sudan, including in the South-

ern Sudan region.[34] In contrast, the Republic of South Sudan is not subject to the Sudanese Sanctions Regulations, but "certain activities in or involving the Republic of South Sudan continue to be prohibited by the SSR, absent authorization from OFAC."[35] In South Sudan, U.S. companies may perform all activities involving the petroleum and petrochemical industries and related financial transactions *except for* the refining in Sudan of petroleum from the Republic of South Sudan.[36]

Although South Sudan does not currently face the same restrictions as Sudan, the United States is preparing a new UN sanctions list for South Sudan after a ceasefire failed to take hold under a new peace accord aimed at ending the South Sudan war that began in December 2013.[37] In addition, in July 2015, OFAC added South Sudanese individuals to its list of "specially designated nationals."[38]

(e) Syria

The Syria sanctions program is one of the most comprehensive sanctions programs currently implemented by OFAC.[39] OFAC's Statement of Licensing Policy permits, in certain circumstances, a U.S. person "to engage in oil-related transactions that benefit the National Coalition of Syrian Revolutionary and Opposition Forces, or its supporters."[40] In August 2015, however, OFAC added Syrian individuals and companies to its list of "specially designated nationals."[41]

(f) Other Countries

For a list of additional nations subject to economic sanctions by the United States, Practitioners should visit http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx.

2. The Importance of Transaction Due Diligence

A number of regulatory compliance regimes impose penalties based upon successor liability. For that reason, companies that are acquiring overseas assets that may be subject to compliance regimes must have a robust due diligence program to identify potential compliance risks. As just one example, Brazil's Clean Company Act "imposes successor liability on companies, giving those companies contemplating M&A activities in Brazil an even more compelling reason to take the time and money to conduct thorough due diligence in advance of closing these types of deals."[42]

C. Customs

The Department of the Treasury establishes regulations for the classification and assessment of duties.[43]

1. Proper Customs Classifications

Import: U.S. Customs and Border Protection (the "CBP") issues "rulings" in response to requests for advice from importers regarding the proper tariff classification. As examples from the oilfield equipment context, CBP has provided rulings on models of collet connectors (used in subsea drilling systems) and blowout preventers.[44] Whether the merchandise is classifiable under one heading or another of the Harmonized Tariff Schedule of the United States ("HTSUS") is primarily determined based on the General Rules of Interpretation.

Export: Export control refers to laws/regulations that control the export of certain commodities or information for reasons of national security and/or protection of trade and foreign policy objectives. Export control classifications are used to determine whether an export license is required.[45] The numeric classification system utilized in the United States relies upon the "Export Control Classification Number" ("ECCN"). Some items, however, are not controlled for export. U.S. export control rules are extraterritorial and follow products to foreign countries.

2. Due Diligence on Freight Forwarders and Customs Brokers

Customs brokers may be held liable for monetary penalties.[46] Further, because the broker acts as an agent of the importer, an importer may have liability for civil penalties as well.[47] The Commerce Department has advised that forwarding agents have compliance responsibilities under the Export Administration Regulations (EAR), but hiring an agent, whether a freight forwarder or some other agent, to perform various tasks, does not relieve a party of its compliance responsibilities.[48] Instead, primary responsibility for compliance with the EAR remains on the "principal parties in interest" (PPI) in a transaction. Generally, the PPIs in an export transaction are the U.S. seller and foreign buyer.[49] To that end, agents are responsible for the representations they make in filing export data. Moreover, no person, including an agent, may proceed with any transaction knowing that a violation of the EAR has, is about to, or is intended to occur.[50]

Some commentators have warned that the "absence of a contract for customs brokers" coupled with "a considerable devolvement of customs functions to brokers could place a U.S. based company at a high risk of violating the U.S. Foreign Corrupt Practices Act (FCPA).[51]

D. Terms and Conditions

1. Commitment to Abide by Compliance Policies

An effective compliance program must inform employees and others subject to the policy that violation of the policy is grounds for discipline, including potentially termination of employment or termination of a contract. For that reason, companies are advised to include violation of compliance policies and governing laws as a basis for termination of an agreement for cause. GE, for example, requires its employees working with third parties to compel those parties to "agree to comply with the relevant aspects of GE's compliance policies."[52]

2. Audit Rights

Companies seeking to maintain a rigorous compliance program and take steps to assure adherence to the program should consider maintaining audit rights over counter-parties. For example, Halliburton Energy Services, Inc.'s 2011 agreement with a supplier of sand for use as a proppant provides, in pertinent part: "Halliburton shall have the right to audit such Supplier's records for a period of two (2) Years from the expiration or termination of this Agreement. This provision shall survive expiration or termination of this Agreement."[53]

3. Agreement on Costs of Investigations, Fines, Penalties, etc.

Companies should also consider seeking indemnity for the costs of investigations and penalties arising from a counter-party's failure to comply with mandatory trade laws and regulations. For example, Baker Hughes Oilfield Operations, Inc.'s 2012 agreement with a supplier of sand for use as a proppant provides that Baker and the supplier fully release and indemnify the other from and against all "claims, costs, causes of action, fines, penalties or other liability" arising out of the other's negligence or willful misconduct in performance of the agreement.[54]

III. Emerging Issues

A. Corporate Social Responsibility

1. What Is CSR?

International corporate social responsibility ("CSR") aims to address the problem caused by multinational corporate enterprises ("MCEs") operating in less-developed countries with regulations perceived to not fully address the needs of workers in the host country. This is a developing field, which is difficult to define. One study identified thirty-seven definitions of corporate social responsibility clustered around five separate dimensions representing different aspects of behavior.[55] In its broadest sense, CSR expands the regulatory landscape by asking companies to consider "both the social and financial impacts of their decisions."[56] To this end, many companies are creating special departments to deal with emerging issues that promise to have global impact. Those issues include corporate social responsibility and management and protection of personal data and information.[57]

2. Scope and Breadth

While the scope of CSR is difficult to define, it permeates the areas of human rights, accountability, governance, community, environment, and supply chain.[58] As with other aspects of trade compliance, companies are "increasingly held responsible for the unethical or socially or environmentally irresponsible acts of third parties, including those of entities several tiers up or down their supply chains."[59]

B. Comparative Investigative Privileges

Corporate compliance and investigative activities are made more complicated for lawyers by the fact that there is no universal protection of communications with in-house legal advisers, and the scope of legal privilege protection can vary among jurisdictions.[60] Several considerations apply when preparing an investigation plan, including whether lawyers on the investigation team can implicate the attorney-client privilege under applicable law. Depending on the jurisdiction, the local privilege may reach locally licensed outside law firm counsel and maybe locally licensed in-house counsel—although jurisdictions like China may not recognize any attorney-client privilege.

Practitioners should always check whether a jurisdiction extends its attorney-client privilege to foreign (such as U.S.) lawyers not in the local bar, and they should never assume that a U.S.-licensed lawyer falls under a foreign-law attorney-client privilege.[61]

1. United States

The U.S. Court of Appeals for the District of Columbia upheld the attorney-client privilege for internal investigations so long as "one of the significant purposes of the internal investigation was to obtain or provide legal advice."[62] "The court held that this test applies even if the investigation has multiple purposes, or the internal investigation was conducted pursuant to a compliance program or company policy or by investigators rather than legal advisers."[63] To safeguard privilege, in-house legal advisers should clearly label their transaction-related communications as legal advice and explicitly document the purpose of internal investigations.[64]

2. China

In China, "despite the attorney's duty to keep information confidential, the authorities and the courts can force attorneys to disclose confidential information and attorney-client communications."[65] In-house lawyers who are not admitted to the local bar or are not registered with PRC's Ministry of Justice do not appear to fall within the scope of lawyers in the PRC who have a confidentiality obligation, so they are not regarded as qualified lawyers in the PRC who have a confidentiality obligation.[66]

3. Russia

Russian law does not have a concept of privilege. However, attorney-client information is still considered confidential as between the attorney and client and in relation to any third parties "but not *vis-à-vis* the state authorities." With respect to the state, there is limited protection for members of the Russian bar, but the majority of Russian lawyers and all in-house lawyers are not bar members and lack the protection.[67] Finally, "[t]here is no privilege for internal communications between in-house lawyers as a matter of Russian law."[68]

4. France

In France, privilege extends only to lawyers in private practice, so that French lawyers who go in-house must resign from the bar, therefore surrendering any claim to privilege."[69] Privilege is "not extended to communications between in-house counsel and employees, officers or directors of a company where such communications were created for the purpose of obtaining legal opinions on matters relating to the company's activities. Consequently, an in-house counsel can neither resist an investigation by public authorities (whether European Union or national authorities)…nor oppose a seizure of his or her communications (except for communications with an external lawyer). In addition, like any witness, in-house counsel can be called to testify or to provide evidence against the company they work for."[70] Given the French legal framework on privilege, [o]pinions of major importance are typically provided by external lawyers so that they are protected by legal privilege.[71]

5. England

In England and Wales, the legal advice privilege protects confidential communications between a client and its in-house or external lawyer, regardless of whether the advice sought relates to contentious or non-contentious matters.[72] In-house lawyers must remember that only legal advice is privileged—not communications relating to business or administration.[73] In contrast, under E.U. law, there is no privilege in communications between in-house lawyers and the internal client, unless the document is prepared exclusively to seek advice from external legal advisers.[74]

6. Germany

Under German law, an attorney-client communication is not privileged, but the lawyer is under a duty not to disclose the information it contains.[75] Protecting documents from disclosure on the basis of privilege, on the other hand, is limited.[76] German case law is split on the issue of in-house counsel attorney-client privilege; this issue remains unresolved.[77]

7. Indonesia

Lawyers have the right to keep their client-related documents confidential; conversely, attorney-client communications held by the client are not protected.[78] Under the Advocate Law, in-house counsel do not enjoy the protections of the attorney-client privilege.[79]

8. Mexico

The "professional secrecy obligation" permits lawyers to refuse to produce information or give witness statements in certain circumstances.[80] While Mexico does not formally distinguish in-house counsel and external lawyers with respect to privilege, courts may ultimately compel in-house lawyers to produce information.[81]

9. Saudi Arabia

Islamic law, Shari'ah, is the controlling law in Saudi Arabia. Applying Shari'ah, Saudi Arabia is one of a handful of countries that does "not recognize the attorney-client privilege and for which confidentiality provisions apply only to domestic outside counsel."[82]

C. Potential Expansion Beyond FCPA

Beginning with Siemens AG, the U.S. Department of Justice and the U.S. Securities & Exchange Commission have increasingly investigated non-U.S. companies and individuals. On 29 May 2013, the DOJ and SEC announced that the French oil giant Total SA (Total) agreed to pay $398 million in penalties and disgorgement for bribing an Iranian official in violation of the FCPA. To date, that was the fourth-largest FCPA fine.[83] Additionally, the SEC and DOJ have also begun to work more closely with foreign law enforcement authorities in enforcing the FCPA and other anti-corruption laws. DOJ, working with the State Department, has begun installing legal advisers and enforcement professionals in countries around the world to work with foreign prosecutors, judges and police in enforcing the FCPA and other anti-corruption laws. Finally, in the spring of 2013 the SEC, the DOJ, and the Federal Bureau of Investigation partnered to conduct a foreign bribery training program that provided intensive training to one hundred thirty foreign investigators and prosecutors from thirty countries.[84]

IV. Conclusion

With dramatic changes in commodity prices, companies have adjusted their international business strategies and competitive tactics. With that adjustment, counsel must remain cognizant of companies' compliance regimes, regulatory frameworks, and mission statements. Counsel should help to identify new risks from those new strategies, and be cognizant of the tools available to them, as well as the limitations, such as diverse privilege rules that impact how compliance regimes are installed, monitored, and tested.

Endnotes

1. Steinberg and Ferrara, *Foreign Corrupt Practices Act (FCPA)*, 25 Securities Prac. Fed. & State Enforcement § 2:31 (2014).
2. *Id*.
3. *Id*.
4. *See* Wright, *Domestic vs. Foreign Corrupt Practices: For Bribery, an International Mind Is More Guilty*, 28 Geo. J. Legal Ethics 989, 995 (2015) (citing 15 U.S.C. § 78dd-1(a)).
5. *See generally* Schwartz and Goldberg, *Carrots and Sticks: Placing Rewards As Well As Punishment in Regulatory and Tort Law*, 51 Harv. J. on Legis. 315, 320-29 (2014).
6. Cassin, *The 2014 FCPA Enforcement Index*, The FCPA Blog (5 Jan. 2015, 7:18 AM), http://www.fcpablog.com/blog/2015/1/5/the-2014-fcpa-enforcement-index.html.
7. S.E.C. Release No. 22880, *Sec. & Exch. Comm'n v. Weatherford Int'l Ltd.*, Civ. A. No. 4:13-Cv-03500 (S.D. Tex.) (26 Nov. 2013).

8. *Id*.
9. Picholz, Henning and Pickholz, *United Kingdom's Bribery Act*, 21 SEC. CRIMES § 5:32 (2014) (citing Bribery Act 2010 (UK), §§ 1-2, 6-7).
10. Saglibene, *The U.K. Bribery Act: A Benchmark for Anti-Corruption Reform in the United States*, 23 TRANSNAT'L L. & CONTEMP. PROBS. 119, 134-35 (2014).
11. Zaheer, *Brazil's Landmark Clean Company Act: Comparison to the OECD Anti-Bribery Convention and Issues*, 28 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 457, 459-60 (2015).
12. Funk and Reider-Gordon, *The "Next Big Thing" in Global Anti-Corruption: The Brazil Clean Companies Act*, 28 WESTLAW J. WHITE-COLLAR CRIME 7, *1 (27 Mar. 2014).
13. *Id.*
14. *Id.*
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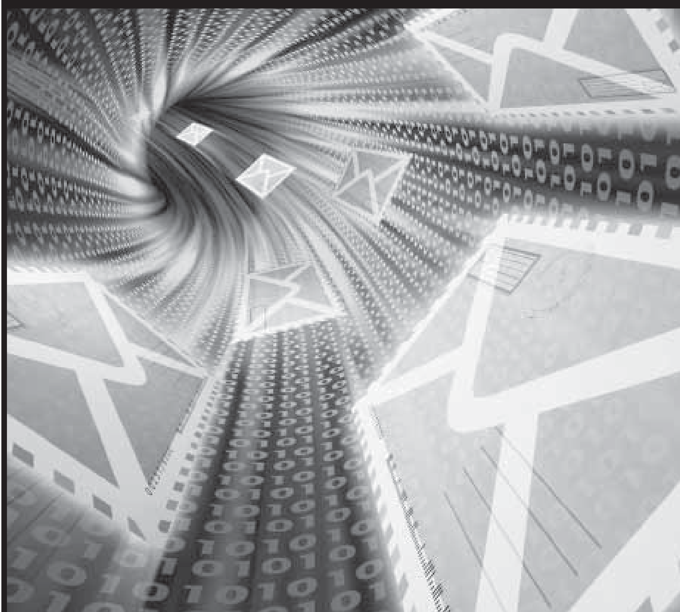

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Confidentiality Waivers in Global Cartel Investigations

By Heather Kafele

I. Introduction

Global cartels attract global attention. Now, more than ever, competition authorities in multiple jurisdictions are concurrently, if not jointly, scrutinizing markets for signs of cartel activity. Where they find it, the activity often spans a region, a continent, or the globe, given the integrated state of world markets. The breadth of cartels has led to convergence among jurisdictions when it comes to the substance of anti-cartel laws and to cooperation among competition authorities when it comes to cartel investigations.

Information sharing is key to cooperative cartel enforcement. Consensus among developed (and, in large part, developing) nations is that competition authorities should share information and evidence so that each jurisdiction involved can effectively prosecute and eliminate cartel activity. But increased willingness to share information raises questions: when and how to share information without violating domestic laws and policies and without impairing the effectiveness of domestic anti-cartel programs? In particular, authorities in one jurisdiction must decide when to convey to foreign authorities information obtained from firms who voluntarily reported that information in exchange for amnesty or leniency.

Competition authorities generally have chosen to preserve the confidentiality of information obtained from amnesty or leniency program applicants unless the applicants consent to disclosure. But policy statements, empirical evidence, and experience in practice show that such consent is routinely obtained —via confidentiality waivers —thus permitting disclosure of information to sister agencies in other countries. Authorities thereby limit the impact of confidentiality policies to advance the global anti-cartel effort.

Although no doubt effective from an enforcement standpoint, the routine use of confidentiality waivers to combat global cartels has significant policy implications. Paramount among these is the risk that "the waiver will swallow the confidentiality rule." That is, if authorities expect a confidentiality waiver as one aspect of the cooperation required to qualify for amnesty or leniency, this expectation could erode the protection that confidentiality affords, thus diminishing the incentive for cartel members to report illegal activity in the first place.

Beyond that, an increase in waiver requests leads to difficult decision-making on the part of defense counsel and clients, who must decide whether, when, and where to self-report and consent to information sharing. Clients often have different levels of exposure in multiple jurisdictions, not least due to variation in the amnesty or leniency available should the client choose to self-report in those jurisdictions. The expectation that amnesty or leniency applicants will waive cross-jurisdictional confidentiality only further complicates decision-making in this environment and underscores the need for a sophisticated and seamless global approach to mitigate cartel-related exposure.

II. Discussion

A. Cooperation on the Rise

Over the past few decades, cartel enforcement programs around the world have converged in many respects. Nations previously without any cartel enforcement have passed anti-cartel laws, jurisdictions without amnesty or leniency programs have developed those programs, and jurisdictions without a history of aggressive anti-cartel enforcement have taken a more aggressive approach to prosecution of these crimes.

This convergence becomes all the more apparent if viewed in terms of investigation-stage cooperation among competition authorities worldwide. By all accounts, information sharing and other cooperative investigation tactics are at an all-time high. This is not least because cartels have become increasingly globalized over time, tracking market integration. A modern cartel may span a region, a continent, or even the entire globe, depending on the commercial sector and the players involved. A purely domestic cartel—that is, one with single-nation operations and impact—is now the exception rather than the rule. It follows that purely domestic cartel enforcement is insufficient from a law enforcement perspective. Competition authorities around the world have come to recognize that global cartels demand global attention, and that cooperative, cross-jurisdictional enforcement tactics often are warranted.

For its part, the U.S. Department of Justice (the "DOJ") has a well-established general objective of promoting cooperation among enforcement authorities where cartel activity affects more than one jurisdiction.[1] The appropriate level of cooperation naturally varies on a situational basis, but a consistently important aspect of this cooperation, in the DOJ's view, is information sharing.[2] All things equal, the DOJ would prefer to disclose to relevant foreign authorities cartel-related information that the DOJ obtains.[3]

DOJ information sharing is consistent with international expectations. The Organization for Economic Cooperation and Development ("OECD"), among other authorities, has recommended that nations develop "appropriate national rules to facilitate investigation and discovery by their respective competition authorities of relevant information within the control of an enterprise under investi-

gation, where such information is located outside the national territories and when its provision is not contrary to the law or established policies of the country where the information is located."[4] The trend, therefore, is toward transparency, as one element of the coordination necessary to combat multinational cartels.

B. Amnesty and Leniency Programs: A Success Story

On the other hand, cooperation and information sharing have their limits. In the United States, the DOJ generally "will not agree to restrictions in plea agreements which limit [its] ability to provide to U.S. or foreign government authorities information obtained from cooperating defendants."[5] But one exception to this rule is equally clear: *amnesty and leniency program applicants are entitled to confidentiality*.

The DOJ operates an amnesty and leniency program (the "DOJ Amnesty Program") that affords a cartel member the opportunity to voluntarily report illegal activity in return for cooperation credit. This program guarantees amnesty for a "first in" (*i.e.*, first reporting) cartel member who reports before the DOJ has received information about the illegal activity from any other source, and discretionary amnesty for a first-in cartel member who reports after the DOJ has begun investigating, so long as the DOJ did not yet have sufficient evidence to convict that cartel member.[6] Amnesty assures that the DOJ will not criminally charge the qualifying firm or its cooperating directors, officers or employees.[7] The DOJ Amnesty Program also offers discretionary leniency for firms that report second or thereafter, and although less favorable than full amnesty, the potential benefits of leniency are significant.[8]

After the DOJ Amnesty Program was modified in 1993 to make the scope of the program clearer and somewhat broader—for example, by making amnesty automatic if a cartel member reports while no investigation is underway, and by making amnesty possible even after an investigation has begun—the number of amnesty applications multiplied to more than twenty per year and led to dozens of convictions and to fines totaling well over $1 billion.[9] The DOJ Amnesty Program is thus viewed by law enforcement as a tremendous success.[10]

Prevailing wisdom is that this success is due in significant part to the DOJ's approach to confidentiality. DOJ "policy is to treat as confidential the identity of amnesty [and leniency] applicants and any information obtained from the applicant."[11] The DOJ will not disclose that identity or information "absent prior disclosure by or agreement with the applicant," *i.e.*, a waiver, or a court order.[12] The U.S. Court of Appeals for the District of Columbia Circuit has endorsed the DOJ's confidentiality policy—finding that, although third-parties can obtain amnesty agreements between cartel members and the DOJ under the Freedom of Information Act ("FOIA"), the DOJ can redact identifying information such as name, date, industry and geographic location, to preserve the confidences of the DOJ Amnesty Program applicant.[13] The confidentiality policy also finds support in law and economics studies, concluding that cross-jurisdictional disclosure of amnesty and leniency applicants' information would reduce the overall volume of amnesty and leniency applications.[14]

Indeed, confidentiality is a key incentive for firms to seek amnesty or leniency in the United States, because a growing number of foreign enforcement authorities are scrutinizing international cartels. Absent inter-jurisdictional confidentiality, self-reporting to one national authority could dramatically expand the scope of a cartel member's potential liability, which could discourage self-reporting.[15] All said, the DOJ confidentiality policy is seen as critical to preserving the integrity of the DOJ Amnesty Program and as a large contributor to the program's success.[16]

This viewpoint has gained traction outside the United States as well. Other jurisdictions not only have developed amnesty and leniency programs or other cooperation programs similar to the DOJ's, they have chosen to preserve the confidentiality of information obtained from program applicants. In certain instances, confidentiality is mandated by "hard" legal prohibitions on disclosure of information voluntarily conferred upon government authorities.[17] Alternatively, confidentiality can be a "soft" policy choice on the part of competition authorities, unsupported by positive legal authority.

Whatever the legal foundation for confidentiality in a particular jurisdiction, nondisclosure absent a waiver of information obtained from amnesty and leniency program applicants is by now a well-established principle worldwide. The DOJ first announced its confidentiality (or, waiver requirement) policy in 1999, and as of 2008, "it is the [DOJ's] understanding that virtually every other jurisdiction that has considered the issue has adopted a similar policy."[18] This confidentiality protection is a significant counterpoint to policies and trends favoring cooperation and information sharing among competition authorities.

C. Waivers: An Exception to the Exception

Just as amnesty and leniency program confidentiality is an exception to the cooperation rule, waivers are an exception to the confidentiality rule. And, notably, waivers—*i.e.*, amnesty and leniency program applicants' consent to inter-jurisdictional disclosure of reported information—have become increasingly common as a limitation on absolute confidentiality.

According to recent policy statements and empirical evidence, the DOJ and certain foreign authorities frequently rely on waivers to permit information sharing.[19] To be sure, empirical evidence (where available) indicates that not all jurisdictions utilize waivers as routinely as the

United States does.[20] But if trends in the United States—historically at the vanguard of global anti-cartel enforcement—are any indicator, the use of waivers to limit the effect of confidentiality policies is becoming a common practice globally, at least among jurisdictions that have developed active cartel enforcement regimes. The implications of this trend are significant.

1. Will the Waiver Swallow the Rule?

One implication is the risk that the routine use of waivers will erode, or "swallow," the confidentiality rule. Confidentiality of reported information is thought to have contributed substantially to the success of the DOJ Amnesty Program and other such programs worldwide, and thus any enforcement tactic that routinely avoids confidentiality should not be taken lightly.

Potentially troubling, at least from the perspective of defense counsel, is the prospect that enforcement authorities will develop an entrenched expectation that amnesty and leniency program applicants will grant waivers as one aspect of the cooperation required to qualify for amnesty or leniency. To illustrate, DOJ Amnesty Program guidelines require "full, continuing and complete cooperation," as does the DOJ's model conditional leniency letter.[21] These materials do not specify the extent to which an amnesty or leniency applicant must comply with DOJ waiver requests, but the materials do require that an applicant grant the DOJ full access to documentary and testimonial evidence within the applicant's custody or control, wherever located.[22] Beyond that, the guidelines and model letter condition amnesty and leniency on plenary cooperation for the duration of a cartel investigation.[23] It is no great leap to assume that a program applicant will feel significant pressure to grant any and all waivers requested during this time, thus permitting the DOJ to communicate with foreign authorities as necessary to eradicate the particular cartel. Experience in practice confirms this. Although, again, the DOJ guidelines do not formally mandate waivers, the circumstances surrounding a typical waiver request are pressurized to say the least, which is somewhat inconsistent with the notion that a confidentiality waiver is a *voluntary* relinquishment of a known right.

We have seen this before. The routine use of waivers to limit confidentiality rules is reminiscent of the DOJ's routine use of "cooperation credit" to procure corporate attorney-client privilege waivers pre-Filip Memorandum.[24] To be fair, there are distinguishing factors. In jurisdictions where confidentiality is a "soft" policy choice, unsupported by any "hard" legal prohibition on information disclosure, the use of a somewhat coercive waiver demand to deprive an entity of confidentiality is a far cry from stripping that entity, by threat of indictment, of its fundamental right to attorney-client privilege.[25] Additionally, as noted, the DOJ Amnesty Program guidelines do not explicitly state that the DOJ will consider whether a program applicant agreed to a waiver in assessing whether the applicant has continued to cooperate and thereby qualify for amnesty or leniency. This further distinguishes confidentiality waivers in the amnesty or leniency context from attorney-client privilege waivers in other pre-indictment scenarios: in the latter, pre-Filip Memorandum federal guidelines expressly permitted consideration of whether the corporation had waived privilege in deciding whether to charge the corporation.[26]

Still, should a "culture of waiver" develop that results in coercive deprivation of the confidentiality assured amnesty and leniency program applicants, this would resemble what existed in the United States for attorney-client privilege waivers pre-Filip Memorandum.[27] It is conceivable that courts, whether in the United States or elsewhere, would take issue with an entrenched expectation of waiver in the amnesty or leniency context should that expectation in fact become coercive.[28]

Moreover, even absent judicial review, the routine use of waivers may become counterproductive from a policy standpoint. As noted, confidentiality of reported information is widely viewed as a key incentive for firms to participate in amnesty and leniency programs, and these programs are essential mechanisms through which authorities learn of cartel activity. If waivers become a commonplace end run around confidentiality, this may discourage firms from reporting illegal conduct in the first place. Time will tell. For now, suffice to say that while there is significant upside to the use of waivers as an information-sharing and enforcement mechanism, there also may be significant downside.

2. Challenges for Defense Counsel Abound

Even putting that concern aside, however, the routine use of waivers complicates the work of defense counsel advising multi-national clients with cross-jurisdictional exposure. Waivers erode informational barriers, and this tends to add uncertainty and complexity to the already difficult task of choosing an appropriate global defense strategy. Three challenges are paramount: (i) varying obligations and exposure across jurisdictions; (ii) risk of cross-jurisdictional disclosure even without a waiver; and (iii) the fact that amnesty or leniency in one jurisdiction does not ensure amnesty or leniency in another.

(a) Variation in Amnesty and Leniency Across Jurisdictions

Different amnesty and leniency programs in different jurisdictions, coupled with information sharing among jurisdictions, complicates the decision of whether, when and where to apply for amnesty or leniency. In theory, transparent policies make for predictable outcomes, thus permitting a global cartel member to develop a sound cooperation strategy—one characterized by, for example, waivers and simultaneous applications for leniency in all jurisdictions where there is significant exposure.[29]

Unfortunately, however, complications abound. Difficult choices stem from cross-jurisdictional variation in: (i) the amount of cooperation and disclosure required to qualify for amnesty or leniency; (ii) the severity of potential sanctions should a party not seek amnesty or leniency; and (iii) the extent to which amnesty or leniency is even available in exchange for cooperation.

First, variation across jurisdictions in the level of information disclosure required, coupled with a prevalence of waivers, creates difficulties. A firm contemplating cross-jurisdictional waivers and parallel leniency requests generally will need to conduct sufficient internal investigation and disclose sufficient information (*e.g.*, documents; testimony) to satisfy the requirements of the most demanding jurisdiction involved—in effect, rising to the highest common denominator of cooperation requirements—and because of this, the firm ultimately may disclose more evidence in certain jurisdictions than the firm would disclose absent cross-jurisdictional information sharing.[30] Failure to uniformly (*i.e.*, across all jurisdictions) satisfy the strictest of cooperation requirements may lead to a loss of credibility when authorities communicate pursuant to confidentiality waivers and discover the discrepancy. This could adversely affect a firm's ability to qualify for amnesty or leniency. Commentary from the OECD underscores this risk:

> Some parties have reportedly tried to make enforcement cooperation arrangements some kind of escape from liability, or to demand commitments about what an agency will communicate to other agencies. But firms are evidently concluding that they cannot "game" the system, trying to feed different information to different enforcers. Programs require the applicants to make complete, good faith disclosures. Discovery through other channels that a party has not been dealing honestly with an agency would lead to revocation of the leniency offered. And a party's refusal to authorise an agency to check with others to confirm the party's good faith, after the party has applied for leniency there, might be considered suspicious. Firms appear to be moving toward accepting that sharing information with all authorities will become inevitable.[31]

As the OECD highlights, waivers make informational barriers porous, forcing a cartel member to make uniform, and often heightened, disclosure in all relevant jurisdictions. Attempting to avoid this by refusing to grant waivers can itself lead to a loss of credibility which can jeopardize amnesty or leniency.

Second, variation across jurisdictions in the severity of sanctions, coupled with a prevalence of waivers, further complicates matters.[32] A firm with exposure in a particular jurisdiction naturally must weigh the costs and benefits of disclosure and a leniency application in that jurisdiction. All things equal, if sanctions are prohibitively severe relative to the likelihood of enforcement action, disclosure in that jurisdiction—including disclosure via a waiver, if requested—may not be advisable. On the other hand, refusing to agree to a waiver could result in a loss of credibility or leverage in a different jurisdiction where the firm has self-reported and where authorities demand continued cooperation. An entrenched expectation of waivers in one jurisdiction can thus prevent a firm from deciding in isolation whether to cooperate in another jurisdiction. What was once an isolated calculation must now factor in potential cross-jurisdictional repercussions. Ultimately, a firm may choose to cooperate in a jurisdiction where sanctions are unduly severe and where the firm would not otherwise cooperate, merely to avoid negative repercussions elsewhere.

Third, variation across jurisdictions in the extent to which amnesty or leniency are even available, coupled with a prevalence of waivers, complicates the decision-making process further still.[33] Where in one jurisdiction full amnesty is available in exchange for full cooperation, and in another jurisdiction only leniency, rather than full amnesty, is available, there is less incentive to cooperate in the second jurisdiction. Likewise, where the second jurisdiction has no amnesty or leniency program at all, that deficiency tends to discourage cooperation in that jurisdiction altogether.[34] In these scenarios, however, a cartel member, again, must carefully evaluate waiver expectations in the jurisdictions where the cartel member does intend to cooperate, to ensure that refusing to agree to waivers vis-à-vis other jurisdictions will not have negative repercussions.

All said, variation in disclosure obligations, sanctions, and available leniency, combined with a greater prevalence of waiver requests, complicates decision-making for a cartel member seeking to cooperate.

(b) Disclosure Even without a Waiver

Further, the calculations discussed above assume that cross-jurisdictional disclosure will turn on whether an informant agrees to a waiver. That is not always a safe assumption. There is significant risk that if one jurisdiction learns of cartel activity, so will others, regardless of whether waivers are utilized. The OECD has emphasized, "Even though agencies undertake not to disclose applications to other enforcement bodies, as a practical matter other agencies are finding out about them quickly anyway."[35] The OECD also noted, "Agencies may share information learned from other aspects of an investigation that follows the leniency application, for example."[36] From this more general, or secondary, information, agen-

cies may deduce which firms likely are cartel members. This underscores amnesty applicants' "self-interest in approaching those other agencies themselves, and quickly"[37]: a firm cannot assume that it monopolizes information flows merely because the jurisdiction in which the firm reported has a confidentiality policy. The firm must instead factor in the risk of waiver-less disclosure.

(c) Independent Amnesty Regimes: No Guarantees

As a final challenge, there is always the risk that a firm who receives amnesty or leniency in one jurisdiction and then grants a waiver and applies for amnesty or leniency in a second jurisdiction, will not qualify for amnesty or leniency in the second jurisdiction even if a program is in place.[38] The risk of different outcomes is exacerbated by "first in" programs such as the DOJ Amnesty Program, where a fellow cartel member could self-report at any time and thereby eliminate amnesty for other firms.[39] In deciding whether, when, and where to cooperate and agree to waivers, firms must take the risk of different outcomes into account and develop a defense strategy accordingly. Well-timed and well-coordinated action is critical, to say the least.[40]

III. Conclusion

In summary, investigation-stage cooperation among competition authorities is at an all-time high. A key aspect of this cooperation is information sharing. Information sharing has its limits—namely, the confidentiality afforded amnesty and leniency program applicants—but authorities increasingly utilize waivers to limit the impact of confidentiality policies. A key, and potentially negative, implication of this trend is that pressure to agree to waivers could erode the benefits of confidentiality, discouraging participation in otherwise successful amnesty and leniency programs. That aside, the routine use of waivers poses significant challenges for defense counsel and clients. A firm facing cartel-related exposure must navigate a path laden with pitfalls: varying obligations and exposure across jurisdictions; risk of cross-jurisdictional disclosure even without a waiver; and the fact that amnesty or leniency in one jurisdiction does not ensure amnesty or leniency in another. Firms must carefully evaluate the conflicting incentives and complications discussed above and must develop a sophisticated and seamless global approach to mitigate cartel-related exposure.

Endnotes

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5. *See* Spratling, note 1 *supra*, § III.
6. *See* U.S. DOJ, Corporate Leniency Policy ¶¶ A, B, *available at* http://www.justice.gov/atr/public/criminal/239524.htm.
7. *Id.*
8. They include (i) the use of a sentencing guidelines range that does not factor in information disclosed by the cooperator which revealed that the cartel was broader than authorities thought; (ii) a "cooperation discount," *i.e.*, a reduction in the applicable fine to below the guidelines range minimum in return for substantial assistance with the investigation; (iii) the use of the guidelines range minimum as the starting point, pre-cooperation discount, for "second in" cooperators in most instances; and (iv) likely agreement to not prosecute most or all culpable individual employees of the cooperating firm. *See* Scott D. Hammond, *Measuring the Value of Second-In Cooperation in Corporate Plea Negotiations*, Presented at The 54th Annual Spring Meeting of the ABA Section of Antitrust Law, Washington D.C. at 3-9 (29 March 2006).
9. *See* OECD, *Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programs* at 7, 12 (2002).
10. *See id.*
11. *Id. See also* Hammond, note 8 *supra*, at 14 n. 23.
12. *Id. See also* Scott D. Hammond and Belinda A. Barnett, U.S. DOJ Antitrust Division, *Frequently Asked Questions Regarding the Antitrust Division's Leniency Program and Model Leniency Letters* ¶ 32 (19 Nov. 2008).
13. *See Stolt-Nielsen Transp. Grp. v. United States*, 534 F.3d 728, 733-35 (D.C. Cir. 2008).
14. *See, e.g.*, Jay Pil Choi and Heiko Gerlach, *Global Cartels, Leniency Programs and International Antitrust Cooperation* (March 2010).
15. *See* OECD Policy Brief, *Using Leniency to Fight Hard Core Cartels* (September 2001) ("Too great a risk that information would be conveyed to other jurisdictions might decrease firms' incentives to come forward.").
16. *See* Spratling, note 1 *supra*, § III; Hammond & Barnett, note 12 *supra*, ¶ 33; Moses Silverman & Aidan Synnott, *Cartel Regulation, United States* ¶ 26 (Paul, Weiss, Rifkind, Wharton & Garrison LLP 2010).
17. *See, e.g.*, Canadian Competition Act § 29 (prohibiting the extra-territorial communication of information in the possession of the Competition Bureau except where the purpose of conveying that information is for the administration or enforcement of the Canadian Competition Act); Choi and Gerlach, note 14 *supra*, at 1 n. 1 (discussing bilateral antitrust cooperation agreements between the United States, on one hand, and Brazil, Canada, the European Union, Germany, Israel, Japan and Mexico, on the other, that foster investigative and technical assistance but do not allow for access to confidential information); U.S. DOJ & Federal Trade Commission, *Antitrust Enforcement Guidelines for International Operations* (April 1995) (noting that at times "foreign statutes purport to prevent persons from disclosing documents or information for use in U.S. proceedings"). *See also Stolt-Nielsen*, note 13 *supra*, 534 F.3d at 733 (recognizing a "colorable basis" for asserting FOIA Exemptions 7(A) and 7(D) as justification for non-disclosure of portions of amnesty agreements). *But cf. Société Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 205-06 (1958) (finding that U.S. District

Court order compelling Swiss entity's disclosure of financial records pursuant to Trading with Enemy Act was justified, notwithstanding Swiss penal laws precluding that disclosure).

18. *See* Hammond and Barnett, note 12 *supra*, ¶ 33. *See also* OECD, Competition Committee, *Best Practices for the Formal Exchange of Information Between Competition Authorities in Hard Core Cartel Investigations* ¶ 5 (October 2005) ("[M]ost member countries have adopted policies pursuant to which they do not exchange information obtained from an amnesty applicant without the applicant's prior permission.").

19. *See, e.g.*, Scott D. Hammond, *Recent Developments, Trends, and Milestones in the Antitrust Division's Criminal Enforcement Program, Presented at The 56th Annual Spring Meeting of the ABA Section of Antitrust Law*, Washington D.C. (26 March 2008) ("Notwithstanding this [confidentiality] policy, the Division routinely obtains waivers to share information with another jurisdiction in cases where the applicant has also sought and obtained leniency from that jurisdiction.").

20. *See* International Competition Network (the "ICN"), Cartels Working Group, *Cooperation Between Competition Agencies in Cartel Investigations*, Report to the ICN Annual Conference, Moscow (May 2007) (discussing six national antitrust agencies, out of twelve reporting the existence of leniency programs, who indicated in survey responses that they had actively utilized waivers to enhance cross-jurisdictional cooperation despite confidentiality policies). As of this survey, which was conducted between 2005 and 2006, authorities in the following jurisdictions reported the use of waivers within the three preceding years: the United States; the European Union; Germany; Canada; Australia; and Hungary. Authorities in the following nations reported that waiver-based cooperation was available but had not been used: Brazil; France; Japan; South Africa; and Switzerland. Authorities in the following nations reported that waiver-based cooperation was not available (due to, for example, the absence of an amnesty or leniency program): Belgium; Israel; Jamaica; Mexico; New Zealand; Netherlands; Portugal; and Serbia. Of the six jurisdictions reporting the use of waivers, the number of cases varied from one to sixteen, and the number of counterparty jurisdictions with whom waivers were utilized in each case varied from one to eight.

21. *See* U.S. DOJ, Corporate Leniency Policy, note 6 *supra*, (ensuring leniency if, among other things, "[t]he corporation reports the wrongdoing with candor and completeness and provides full, continuing and complete cooperation to the Division throughout the investigation"; U.S. DOJ, Model Conditional Leniency Letter (requiring the same and imposing, as one aspect of cooperation, the obligation that the applicant "provid[e] promptly, and without requirement of subpoena, all documents, information, or other materials in its possession, custody, or control, wherever located, not privileged under the attorney-client privilege or work-product privilege, requested by the Antitrust Division in connection with the anticompetitive activity being reported…"), *available at* http://www.justice.gov/atr/public/criminal/239526.htm.

22. *See id.*

23. *Id.*

24. *See Principles of Federal Prosecution of Business Organizations* (28 Aug. 2008) ("Filip Memorandum"), U.S. Attorneys' Manual, Tit. 9 Ch. 9-28.000 (precluding consideration of whether a corporation waived privilege in deciding whether to criminally charge the corporation).

25. *See Upjohn v. United States*, 449 U.S. 383, 389 (1981) ("The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law.").

26. *See Principles of Federal Prosecution of Business Organizations* at 9 (12 December 2006) ("McNulty Memorandum").

27. *See* Nathanson and Tosch, *Walking the Privilege Line*, N.Y.L.J., 13 July 2009, *available at* http://www.shearman.com/walking-the-privilege-line-08-20-2009/.

28. *Cf. United States v. Stein*, 435 F. Supp. 2d 330, 382 (S.D.N.Y. 2006) (dismissing indictments against thirteen executives at accounting firm, KPMG LLP, due to government pressure for firm to waive corporate attorney-client privilege and cease paying legal fees on behalf of indicted executives in exchange for corporate deferred-prosecution agreement).

29. *See* Scott D. Hammond, *The U.S. Model of Negotiated Plea Agreements: A Good Deal with Benefits for All*, Address to the OECD Competition Committee, Paris § I (17 October 2006) (stating that the result of increased transparency regarding leniency programs is, or at least should be, "informed decisions to simultaneously apply for full immunity in multiple jurisdictions where [cartel members] face the prospect of severe sanctions"). *See also* OECD, Policy Brief, *Using Leniency to Fight Hard Core Cartels*, note 15 *supra*: "Already, companies are coming forward simultaneously in all the major jurisdictions with leniency programs."

30. *See* Marc Hansen, Latham & Watkins (London) LLP, *Procedural and Substantive Conflicts in Multi-Jurisdictional Cartel Investigations*, Presented at the Fair Trade Center, Tokyo (8 Oct. 2010).

31. *See* OECD, *Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programmes*, note 9 *supra*, at 22.

32. *See* Hansen, *Procedural and Substantive Conflicts in Multi-Jurisdictional Cartel Investigations*, note 30 *supra*.

33. *See id.*

34. *See* ICN, *Cooperation Between Competition Agencies in Cartel Investigations*, note 20 *supra*, at 11-13, Annex 2(a) (survey responses indicating no use of waivers due to the absence of any amnesty or leniency program); Hammond, *Recent Developments, Trends, and Milestones in the Antitrust Division's Criminal Enforcement Program*, note 19 *supra*, referring to routine use of waivers where an amnesty applicant has sought and obtained leniency from multiple jurisdictions.

35. *See* OECD, *Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programmes*, note 9 *supra*, at 22.

36. *Id.*

37. *Id.*

38. *See* Seth C. Farber and A. Paul Victor, *Defending Against an International Cartel Investigation: Factors to Consider in Determining Whether to Seek Immunity or Otherwise Cooperate with Affected Jurisdictions,* in Antitrust Enforcement: Focus on Criminal Cartels ¶ 2 (Dewey & LeBoeuf LLP, August 2011) (noting that seeking leniency in one jurisdiction does not, by any means, ensure receipt of cooperation credit in another jurisdiction); OECD, Policy Brief, *Using Leniency to Fight Hard Core Cartels*, note 15 *supra*: "Agencies may make it clear that they will act independently."

39. *See* OECD, *Fighting Hard Core Cartels: Harm, Effective Sanctions and Leniency Programs*, note 9 *supra*, at 22, discussing difficulties arising from the contrast between programs such as that in the United States, which make an unconditional promise of amnesty if certain specified criteria are met (e.g., the applicant is "first in"), and programs such as that in the European Community, where there is "no formal mechanism by which a company can get an idea early on about the likely outcome if it continues to cooperate with the Competition Directorate's investigation.

40. *See* OECD, *Using Leniency to Fight Hard Core Cartels*, note 15 *supra*, discussing the need for a company to timely "seek leniency simultaneously in each and every jurisdiction where it believes it has a significant problem."

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"I'm Never Too Far Away": Extradition of Non-U.S. Nationals Charged with Price-Fixing*

By Jay L. Himes and Rudi Julius

I. Introduction

Cartels—price-fixing agreements by competitors—are bad. U.S. Assistant Attorney General for Antitrust Joel Klein once called cartels "the equivalent of theft by well-dressed thieves…[G]overnments should be every bit as willing to work together on fighting cartels as they are to combat securities fraud, tax fraud, and other types of international fraud and theft."[1] More recently, cartels have been described as "a direct assault on the principles of competition" that is "universally recognised as the most harmful of all types of anticompetitive conduct… Any debate as to whether cartel conduct should be prohibited has been resolved, as the prohibition against cartels is now an almost universal component of competition laws."[2]

So, cartel members who inflate prices paid in the United States ought to be punished for their price-fixing.[3] And if they are non-U.S. nationals who decline to submit to U.S. judicial authority, they should be extradited to the United States where the full force of law can be brought to bear—right? The Antitrust Division of the U.S. Department of Justice is trying. But the question remains: is extradition a roaring tiger—or a paper one?

We provide below background for this topic, and an overview of extradition. Then, we discuss recent extraditions to the United States of non-U.S. nationals facing antitrust-related criminal charges. We conclude with "takeaways" from these extraditions.

II. Go to Jail. Go Directly to Jail. (Not Exactly)

A key feature of U.S. Antitrust Division criminal enforcement is individual accountability—the notion that corporate executives and employees, and not just their company, should be held responsible for price-fixing and other hard-core antitrust violations: "[e]ffective cartel enforcement requires holding accountable both corporations and the senior executives who orchestrate their unlawful conduct."[4] Thus, the Antitrust Division regularly brings criminal cases against not only corporations but also individuals who participated in the violation. Moreover, in recent years Antitrust Division criminal enforcement has focused heavily on international cartels—conspiracies that increase prices in both the United States and other regions worldwide and that also frequently involve non-U.S. companies.[5] Put the two together—individual accountability and international cartel enforcement—and the result is many criminal antitrust cases against non-U.S. nationals.

Once upon a time a non-U.S. national could resolve U.S. criminal price-fixing charges by agreeing to plead guilty in exchange for cooperating with the Antitrust Division and the Division agreeing to recommend a sentence that did not require the individual to serve time in a U.S. federal prison. Although the plea agreement between the two was not binding on a U.S. federal judge, who by law must approve the deal, the judge tended to avoid second-guessing the Antitrust Division. Absent an agreed-upon plea and sentence recommendation, the Antitrust Division could well be left holding an empty bag: a criminal antitrust case against an individual outside the United States that the Antitrust Division could not prosecute. No prison time was the trade-off for the non-national's submission to the U.S. court's jurisdiction in order to plead guilty and for the individual's assistance to the Antitrust Division in its ongoing investigation. The guilty plea required the individual to admit criminal wrongdoing, and that was itself a message that the Antitrust Division wanted to send to the business community: in the United States price-fixing *is* a criminal felony.

Those times are gone, however. The "watershed" event came in 1999 when a Swiss executive agreed to plead guilty *and* to accept a four-month prison term for participating in the vitamins cartel.[6] Since then, more than fifty individuals from over twenty countries have served or been sentenced to serve time in U.S. prisons for price-fixing or obstructing a federal antitrust investigation.[7]

Under U.S. antitrust law, price-fixing is punishable by up to ten years' incarceration for individuals.[8] And Antitrust Division officials leave no room for doubt: "the most effective way to deter and punish cartel activity is to hold culpable individuals accountable by seeking jail sentences."[9] Accordingly, the Division's announced policy is that individuals charged with criminal antitrust violations should expect to receive a sentence that includes prison time. The policy applies to "*all* defendants, domestic and foreign."[10] Although the Antitrust Division still engages in plea bargaining, a non-prison time recommendation generally is off the table: "We will not agree to a 'no-jail' sentence for any defendant."[11]

If that policy discourages non-nationals from pleading guilty and encourages them to remain at large outside the United States, the Antitrust Division is prepared to live with the result. The Division's jail-for-price-fixers policy is strongly held. Consider the case of *United States v. Chen*.[12]

Chen had directed his company to file a private civil antitrust case in federal court in California against the members of the very price-fixing conspiracy in which his company had participated. The civil case itself exposed the conspiracy, and caused ***another*** one of its members to seek and receive Antitrust Division leniency, which in turn produced the Antitrust Division's investigation and prosecution of the cartel's remaining members—including Chen's company and Chen himself. Chen cooperated with the Division and agreed to plead guilty.

On sentencing, Chen—then residing in India and doing community service work—argued for a sentence of six months' probation, which the U.S. probation department supported.[13] Among the materials that Chen submitted to the court was his prior attorney's sworn statement that, in discussing a civil case against the conspiracy, he "advised" Chen not to seek leniency from the Division because it "likely would not be worthwhile."[14] The Antitrust Division *opposed* probation, and urged six months in prison: "[a] non-custodial sentence," the Division maintained, "would be a slap on the wrist that would not afford adequate general deterrence…."[15] The court rejected the Division's recommendation and sentenced Chen to the one year's probation, with the first six months consisting of monitored "house arrest" in California.[16]

III. To Be, or Not to Be…Extradited

The Division's most far-reaching current criminal investigation—the long-running "auto-parts" investigation—has returned criminal charges (grand jury indictments or prosecutors' criminal "informations," used with plea agreements) against fifty-two non-nationals.[17] Twenty-nine have pleaded guilty, and the rest are mostly at large living outside the United States.[18] Those individuals under indictment who have not submitted to the U.S. federal court's jurisdiction are "fugitives" under the law.[19] The U.S. DOJ's long-running investigation of financials services products, in which the Antitrust Division has participated, has also produced indictments against non-U.S. nationals.[20] Overall, dozens of individuals indicted for cartel violations are reportedly living as fugitives outside the United States.[21]

A criminal charge brought against an individual not subject to the U.S. court's jurisdiction may seem like a pyrrhic victory. But U.S. criminal charges—which will remain pending indefinitely under U.S. law—can have significant personal and professional consequences.[22] For some, living under the cloud of a felony indictment is simply an uncomfortable state of affairs.[23] There are likely to be recurring jokes and other unpleasant-to-hear comments. Potential employers may be less likely to hire.

Equally important, however, as nations around the world adopt legislation that criminalizes price-fixing, the risk of extradition to the United States to stand trial increases—and here the trend favors the Antitrust Division. Even where extradition from the individual's nation of residence is not possible, international travel, whether for business or personal reasons, may be difficult. Travel will require the individual to take account of the potential for detention and extradition to the United States to stand trial on the antitrust charge. Recently, an indicted Italian national was arrested after temporarily stopping in Germany, and thereafter extradited to the United States, thus leading to a guilty plea for price-fixing. Although indicted individuals can reconcile themselves to planning air travel specifically to avoid landing in nations where extradition is possible, even that approach is hazardous. "The best laid schemes o' mice an' men/Gang aft a-gley, [often go awry]."[24] Weather conditions, ill passengers, and equipment malfunctions, among other circumstances, can result in unscheduled landings in the "wrong" country. Thus, "the costs of being a fugitive are very, very real."[25]

To better appreciate not simply the hazards that a non-U.S. national charged with price-fixing faces, but also the impediments to extradition that the Antitrust Division itself may need to overcome, a fuller discussion of extradition is useful.

IV. Extradition for Dummies

Extradition—"the formal process by which a person found in one country is surrendered to another country for trial or punishment"—is normally "regulated by treaty" between two countries, which establish the circumstances and terms of surrender.[26] The United States has extradition treaties with more than one hundred countries.[27] These treaties require that a request for extradition be made through diplomatic channels, although a request for provisional arrest may sometimes be made to an executive official directly, such as the U.S. DOJ, and executed by a judicially-issued warrant.[28] Because extradition is governed by treaty, the process for determining extraditability and review of that finding can differ. However, in the United States the federal courts have a limited role: "Extradition is an executive, not a judicial, function" which "derives from the President's power to conduct foreign affairs."[29] Thus, generally the Secretary of State has review authority over a judicial finding of extraditability to a foreign nation.[30]

To be enforceable, the extradition treaty must authorize the particular extradition request. Many older treaties contained lists of extraditable offenses, rather than a "seriousness of the offense standard to determine the applicability of the treaty."[31] The U.S.-Brazil extradition treaty, for example, lists thirty-two specific crimes or categories of crimes, plus "attempt" or "participation" in the enumerated offenses.[32] Antitrust violations are not on the list.

Older treaties, many of which date back to the nineteenth century, are being updated to increase their effectiveness, and new treaties are being developed with

an eye towards modern enforceability.[33] For example, in the late 1990s, the United States revealed an ambitious agenda to update many of its older bilateral extradition treaties, focusing on the treaties with those countries with which it has or can anticipate a significant interest in seeking extraditions.[34] In 1998, the U.S. Senate approved eighteen extradition treaties—the largest group of law enforcement treaties ever addressed at once.[35] Sixteen of these treaties were entirely new, and two were protocols to existing treaties with Mexico and Spain.[36]

Older treaties are also being updated by using categories of offenses to increase their effectiveness.[37] Updated treaties commonly state that the offense at issue need not be categorized within the same class of offenses in each nation to be extraditable.[38] For instance, while the United States classifies bid-rigging as an antitrust violation, other countries may classify it as a fraud. Because more jurisdictions impose criminal penalties for fraud than for competition law violations, the ability to disregard classification differences can increase the Antitrust Division's opportunity to secure extradition.[39]

Similarly, migrating from lists of extraditable offenses to categories can ease the way for extradition. Where a country did not historically have antitrust laws, there was nothing to put on the list, and even where the country had enacted antitrust legislation, typically the offense was not criminal, and thus not on the list for that reason.

A. Bad in Both Places: The "Dual Criminality" Requirement

Extradition treaties tend to include the principle of "dual criminality," which authorizes extradition only where the conduct charged "is a sufficiently serious criminal offense (*i.e.*, usually punishable by a year or more in prison) under the laws of *both* the country seeking extradition *and* the country receiving the extradition request."[40] The U.S.-Brazil extradition treaty, for example, requires dual criminality.[41] Typically, extradition treaties address dual criminality in one of three ways: (i) by listing extraditable offenses and not otherwise speaking to the issue; (ii) by listing extraditable offenses *and* containing separate provisions requiring dual criminality; or (iii) by identifying as extraditable those offenses condemned by the laws of both nations.[42]

Dual criminality can impose a significant obstacle to extradition on U.S. antitrust charges. Most nations' antitrust (competition) laws do not make violation a criminal offense. However, over the past twenty-odd years, the Antitrust Division has successfully exported globally the leniency program idea by which antitrust violators who self-report to enforcement officials are relieved in whole or in part of otherwise available sanctions for violation. Now, the Antitrust Division has set its sights on criminalization. As Brent Snyder, Deputy Assistant Attorney General for criminal enforcement, has noted: "Much like we have had a proliferation of leniency programs in recent years, we also have seen more and more jurisdictions that are adopting criminal antitrust statutes, and—that will make extradition more easy to obtain."[43]

There is, indeed, a growing trend globally toward criminalization.[44] More than thirty countries have adopted criminal penalties for cartel activity.[45] They include, to name only a few, the following:

Australia	Brazil	Canada
Czech Rep.	Denmark	Estonia
Greece	Iceland	Ireland
Israel	Japan	Mexico
South Africa	South Korea	United Kingdom

But remember, criminalization is one thing. *Individual* accountability for the antitrust crime is another. A corporation can't be extradited.

Remember also, that dual criminality may be necessary for extradition, but not sufficient. If antitrust violations are not on the list of extraditable offenses, it is immaterial that the conduct is criminal in both nations. Brazil is an example: "Brazil has emerged as the new leader in Latin America in combating cartels…. Brazil fines more hard-core cartels annually and imposes higher average corporate cartel fines than any other country in the region; it is also alone in Latin America in regularly fining cartel managers."[46] Nonetheless, as noted above, antitrust violations do not make it to the list of extraditable offenses under the U.S.-Brazil treaty. Hence, dual criminality, although satisfied, is not enough.

B. Other Extradition Hurdles

Meeting the dual criminality requirement is just one step along the path leading to extradition. There are many other barriers that may need to be overcome, such as statute of limitations considerations, probable cause requirements, and double jeopardy. The limitations vary, treaty-by-treaty, and are applied on a case-by-case basis. The following are examples of ones of more general application.

1. Protection of Citizens

Some nations, either by law or by practice, forbid extradition of their own citizens.[47] Indeed, in rejecting extradition of a U.S. national to France, Judge Learned Hand once wrote that "most nations have shown a persistent repugnance to submit their citizens to foreign courts."[48] The U.S. Supreme Court affirmed:

> [W]e are constrained to hold that [the President's] power, in the absence of statute conferring an independent power, must be found in the terms of the treaty and that, as the treaty with France fails to grant the necessary authority, the President is without power to surrender the respondents [U.S. citizens].[49]

The U.S. Congress has since enacted legislation conferring discretionary authority on the Secretary of State to extradite U.S. citizens if not expressly provided for in a bilateral treaty.[50] Nevertheless, among members of the international community generally, the historic "repugnance" that Judge Hand identified has traction. The U.S.-France bilateral treaty, for example, provides, in effect, that France will not extradite its own citizens, although the United States may exercise its discretion to do so.[51] The U.S.-Brazil treaty, on the other hand, recognizes that either nation may, by law, confer on itself the discretion to extradite its own citizens:

> There is no obligation upon the requested State to grant the extradition of a person who is a national of the requested State, but the executive authority of the requested State shall, subject to the appropriate laws of that State, have the power to surrender a national of that State if, in its discretion, it be deemed proper to do so.[52]

Nations that decline to extradite their own citizens sometimes have their own laws giving them jurisdiction over crimes committed not only within their own territory but also abroad by or against citizens. This approach then exists to prosecute citizens accused of crimes committed abroad as if the crime had occurred within the country's borders.[53]

2. Public (or National) Sentiment

Even where no express treaty provision or law bars extradition of a requested nation's citizens, the extradition process remains discretionary.[54] In some nations, cartel offenses do not have the level of disapprobation currently held in the United States (among antitrust enforcers at least). Thus, there can be a disinclination to extradite. As criminalization takes hold, and as countries themselves prosecute antitrust violations criminally, this sentiment may change. Certainly, the Antitrust Division would welcome that development.

Japan, for example, permits criminal prosecution for antitrust violations and has brought criminal cases against price-fixing and bid-rigging with increasing frequency in recent years.[55] Moreover, Hideo Nakajima, Japan's top-level antitrust enforcer, has commented that public sentiment against cartels in Japan appeared to be getting stronger.[56] However, the United States has yet to seek extradition of a Japanese national for a cartel violation.[57]

Public attitudes toward price-fixing are difficult to gauge. However, some data can be read to support emerging public awareness that price-fixing should be treated as a crime. The responses to recent extensive surveys in the United Kingdom, Germany, Italy and the United States "suggested overwhelming support for criminalization" of price-fixing, ranging from seventy-six percent in favor in the United Kingdom and the United States to eighty-seven percent in Germany.[58] Support for imprisonment of individuals was much lower, however, ranging from twenty-six percent in favor in Italy to thirty-six percent in the United States.[59] Moreover, "[o]n balance respondents do not consider price-fixing to be as serious as theft, but more than 50% of respondents in the United Kingdom, Germany and the United States do consider it to be equivalent to a fraud. This is significant because in their minds price fixing has the same qualities of delinquency as the appropriation of money through some misrepresentation or deceit."[60]

Time may, therefore, be on the Antitrust Division's side.

3. Location of Criminal Conduct

Some nations are disinclined to extradite to the United States unless there was criminal conduct in the United States itself, and not just overseas activity. If a cartel held its meetings only outside the United States, and somehow avoided communicating to persons in the United States in furtherance of the conspiracy, extradition might not be available under some treaties. If, however, the requested country similarly made criminal acts outside its own territory, extradition to the United States might be available. The U.S.-Brazil treaty is illustrative:

> When the crime or offense has been committed outside the territorial jurisdiction of the requesting State, the request for extradition need not be honored unless the laws of the requesting State and those of the requested State authorize punishment of such crime or offense in this circumstance.[61]

C. Sentries at the U.S. Border and Cops on the Worldwide Beat

To assist in investigating and prosecuting international cartel participants, the Antitrust Division regularly uses border watches in the United States to detect not only individuals under indictment entering the country, but also potential witnesses and even potential defendants.[62] In one recent investigation, for example, the Division arrested an ***unindicted*** Taiwanese national at Los Angeles International Airport on a stopover while on his way to

Mexico and Central America.[63] Having taken the individual into custody, the Division promptly indicted him. Released on bail—but restricted to the northern California area, and monitored electronically—he remained in the United States pending his criminal trial.[64] After more than a year of pretrial proceedings, the individual pleaded guilty and was sentenced to prison.[65]

At the international level, the Antitrust Division relies on INTERPOL "red notices"—"essentially an international wanted notice that many of Interpol's member countries recognize as the basis for a provisional arrest, with a view toward extradition."[66] Individuals on the Red Notice list are wanted by national jurisdictions for prosecution or to serve a sentence stemming from an arrest warrant or court ruling.[67] When police encounter a person whose name is listed, the country that sought the listing is notified though Interpol and can either request his provisional arrest (in emergency situations) or can file a formal request for extradition.[68]

The Antitrust Division began "Red Listing" individuals indicted on antitrust violations in 2001.[69] The Division's stated policy is to "seek to extradite any fugitive defendant apprehended through the Interpol Red Notice Watch."[70] Thus, even if an individual's nation of residence will not extradite on cartel charges, an indicted cartel participant is exposed to the risks of arrest and extradition to the United States while traveling internationally upon entry into a country where extradition is available. As the cases below reflect, the Antitrust Division is prepared to implement its extradition policy.

V. Nowhere to Hide: Recent Extraditions to the United States

In a 2007 speech Assistant Attorney General Thomas O. Barnett emphasized that "[w]ith the increasingly vigorous resolve that foreign governments are taking toward punishing cartel activity and their increased willingness to assist the United States in tracking down and prosecuting cartel offenders, the safe harbors for antitrust offenders are rapidly shrinking."[71] Three years later, the Antitrust Division successfully extradited a CEO from the United Kingdom to stand trial on an obstruction of justice charge arising from a price-fixing investigation. This was the first time that the Division secured extradition of a foreign national on an antitrust-related charge. In 2014, the Antitrust Division secured its first extradition on a price-fixing charge, this time from Germany. Two other extraditions, one from Canada and the other from Israel, are also noteworthy. We discuss these cases below.

A. Ian Norris (Extradited from the United Kingdom)

The 2010 extradition of Ian Norris, the CEO of the Morgan Crucible Company plc, resulted from a multiyear battle. More than a decade earlier, the Antitrust Division began an investigation into price-fixing in the electrical carbon products industry. Morgan Crucible, a U.K. company, pleaded guilty in 2002 to witness tampering and document destruction, and was ordered to pay a $1 million criminal fine.[72] A Morgan U.S. subsidiary pleaded guilty to price-fixing, and was fined $10 million (the statutory maximum at the time), while three of Norris's subordinates were sentenced to prison after pleading guilty to charges of obstruction of justice, witness tampering, and destruction of documents.[73]

In 2004, a U.S. federal grand jury indicted Norris, a U.K. citizen, for price-fixing, conspiracy to obstruct justice, and obstruction of justice in connection with the Division's investigation.[74] The Antitrust Division sought extradition, and both the U.K. trial court and Court of Appeals ordered Norris extradited to the United States on the price-fixing charge.[75] But in March 2008, the U.K. House of Lords ruled that Norris could not be extradited because price-fixing was not a criminal offense in the United Kingdom at the time of Norris' alleged conduct.[76] Thus, the principle of dual criminality barred extradition. The House of Lords, however, did not preclude Norris' extradition on the obstruction of justice charges, which were criminal offenses in the United Kingdom as well as in the United States

In 2009, a U.K. court ordered Norris extradited to the United States to stand trial for obstruction of justice.[77] Norris was unsuccessful in appeal efforts that went all the way to Supreme Court of the United Kingdom and the European Court of Human Rights.[78] In March 2010, Norris became the first non-U.S. national extradited to the United States on charges arising from an antitrust investigation. At a trial later in 2010, a U.S. jury found Norris guilty of obstruction, and he was sentenced to eighteen months in prison. The U.S. Court of Appeals in Philadelphia upheld his conviction and sentence.[79] Norris thus was also the first extradited non-national to go to prison after an antitrust-related conviction.

Norris's extradition was a substantial step towards dispelling any perception that non-U.S. nationals were safe from U.S. antitrust-related prosecution unless they voluntarily agreed to face charges in the United States, typically as part of a plea deal. As then-Assistant Attorney General for antitrust Barnett, declared, "The United States's efforts in the *Norris* case should send a powerful signal that cartelists will not be allowed to hide behind borders."[80]

B. David Porath (Extradited from Israel)

The extradition of David Porath arose from a scheme that began in 2000 to rig bids for contracts at New York Presbyterian Hospital, a major New York City health care facility. During the 2005-06 period, Porath cooperated with the DOJ, and wore a "wire" to help secure evidence against others participating in the scheme. However, in mid-2006, he ceased cooperating, and in 2009 traveled to

Israel, where he had dual citizenship. In February 2010,[81] the Antitrust Division charged him with bid-rigging and tax offenses.[82] In 2011 the DOJ sought extradition, which an Israeli magistrate granted. Porath then waived appeal and in 2012 consented to be extradited to the United States. He pleaded guilty in July 2012.[83]

C. Romano Pisciotti (Extradited from Germany)

In 2014, the Antitrust Division secured its first extradition on an antitrust charge when Romano Pisciotti, an Italian national and executive of marine hose manufacturer Parker ITR Srl, was extradited from Germany. The extradition arose from the Division's investigation into bid-rigging and price-fixing in the marine hose industry.[84] Parker ITR, Pisciotti's employer, pled guilty to cartel violations in February 2010 and agreed to pay a $2.29 million criminal fine.[85] Four other companies and nine individuals also entered guilty pleas.[86]

Pisciotti, an Italian national living in Italy, was himself indicted in August 2010.[87] Nearly three years later, in June 2013, German officials arrested him at the Frankfurt airport, where he was about to transfer planes en route to Nigeria from Italy. Because Germany also criminalizes bid-rigging violations, and because Pisciotti was not a German citizen, the German government agreed to extradite Pisciotti to the United States under its bilateral extradition treaty. The Higher Regional Court of Frankfurt upheld extradition in April 2014.[88] Pisciotti was unsuccessful in challenging the extradition under German and E.U. law and before the European Court of Human Rights.

Once in the United States, Pisciotti faced trial in the U.S. federal court in south Florida.[89] However, on 24 April 2014, three weeks after extradition, Pisciotti pleaded guilty and was sentenced to twenty-four months in prison and fined $50,000 for participating in the marine hose conspiracy.[90] Bill Baer, Assistant Attorney General in charge of the Antitrust Division, noted that Pisciotti's guilty plea "demonstrates the Antitrust Division's ability to bring to justice those who violate antitrust laws, even when they attempt to avoid prosecution by remaining in foreign jurisdictions."[91]

D. John Bennett (Extradited from Canada)

The most recent extradition involving antitrust-related charges is that of Canadian executive John Bennett for allegedly participating in a bid-rigging conspiracy. Bennett was CEO of Bennett Environmental Inc., a Canadian soil remediation company. In December 2008, the company pled guilty to conspiring to defraud the U.S. Environmental Protection Agency (EPA) and was ordered to pay a $1 million criminal fine and restitution to the EPA of $1.66 million.[92]

Bennett's own indictment on charges of fraud, kickbacks, and bid-rigging of contracts at EPA Superfund (remediation) sites was publicly disclosed in September 2009.[93] A co-defendant who stood trial was convicted by a jury of multiple criminal violations, and sentenced to fourteen years in prison, the longest prison sentence that has been imposed in a case that included antitrust violations.[94] Another co-defendant pled guilty and was sentenced to thirty-three months in prison.

In February 2010, the U.S. DOJ applied for extradition from Canada. Although Bennett challenged the extradition in the Canadian courts, in October 2014 the Supreme Court of Canada declined to hear Bennett's appeal, thus clearing the last obstacle to extradition.[95] Two weeks later, Mr. Bennett arrived in the United States, where he has since pleaded not guilty and is scheduled to go to trial in November 2015.[96] Assistant Attorney General Baer commented, "This extradition demonstrates our resolve to pursue those who undermine competition. And it is yet another example of our longstanding cooperation with our enforcement colleagues in Canada's Department of Justice, which helps ensure that those who subvert competition in the United States and elsewhere are brought to justice."[97]

VI. Carry-outs (aka "Takeaways")

Several themes emerge from the Antitrust Division's recent extraditions:

First, the Antitrust Division and the U.S. DOJ overall are in it for the long-haul—not just when it comes to extradition generally, but also where individual extraditions are concerned. Extradition is a time-honored principle of international relations. As commerce among nations become increasingly interconnected, and as the speed and ease of physical travel, transfer of property (tangible and intangible) and communications increase, the opportunities for cross-border criminal conduct increase—and so too does the need for international law enforcement cooperation. Extradition takes on correspondingly increased importance. Compared to crimes of violence and even many other non-violent crimes directed to property, antitrust is new to the block. But the Antitrust Division has settled in, likes the neighborhood, and is committed to staying put.

Second, once the Antitrust Division indicts, the Division is enforcement-resolute, and its commitment applies equally to extradition. The Norris extradition in 2010 involved conduct in the 1999-2000 time-period, and the extradition itself was a multi-year battle. The Antitrust Division persisted even after a losing extradition in the U.K. House of Lords, then the United Kingdom's highest appellate tribunal. Similarly, Bennett's extradition in 2014 arose from criminal conduct in 2002,[98] and likewise was protracted. Pisciotti's 2014 extradition was based on bid-rigging that began at least as early as 1999,[99] and Porath's 2012 extradition arose from a scheme that began in 2000.[100]

Third, the Antitrust Division chooses its extradition requests strategically. "A journey of a thousand miles begins with a single step."[101] Therefore, starting off pointed in the right direction is a good idea. Take Norris. The obstruction arising from the Division's investigation was egregious, admitted to in guilty pleas by subordinates in the United States, and implicated a CEO located in the United Kingdom, with which the United States has a "special relationship."[102] As test cases go, this one was pretty good. So too with Bennett, which involved bid-rigging that damaged the public fisc and involved a high-ranking corporate official located in Canada, another nation with which the United States has uncommonly close relations.

Fourth, as Pisciotti's extradition illustrates, "stuff happens," and when it does, the Antitrust Division is ready to seize the moment. The Red Notice list worked. Pisciotti was caught. The Antitrust Division not only nabbed a price-fixer, it also reinforced a message to the international business community: if you are under an Antitrust Division or, indeed, other U.S. indictment, you travel internationally at risk.

Fifth, communications and technological innovations improve international law enforcement, and increase the opportunity to detect, detain, and extradite individuals under indictment. Again, we see that from Pisciotti's extradition.

Sixth, price-fixers often commit other crimes. The crimes can arise from the antitrust investigation—as in Norris' situation—or they can be "stand-alone" criminal offenses. The Antitrust Division, sometimes working with other parts of the DOJ, has often charged other crimes.[103] Those other crimes can provide a basis for extradition, and thereafter trial in the United States, even where price-fixing does not. Norris is illustrative. Bennett, too, was extradited on charges of bid-rigging, fraud, and kickback offenses, and Porath on bid-rigging and tax violations.

Seventh—a close cousin to number six—partial antitrust criminalization itself can be enough to satisfy the dual criminality generally needed for extradition. Although Germany does not currently criminalize price-fixing generally, bid-rigging is criminal. So, Pisciotti could be extradited.

Finally, as Porath's extradition illustrates, "in for an inch, in for a mile." Although Porath began by assisting the Antitrust Division's investigation (no doubt trying to make the best out of an already bad situation), he changed his mind and went to Israel. This circumstance is not going to sit well with the Division. That Porath's indictment and extradition would follow should come as no surprise.

VII. Conclusion

As noted earlier, the Antitrust Division's auto-parts investigation has resulted in indictments of many individuals living in the Far East who have not, thus far, submitted to the U.S. federal court's jurisdiction. The argument has been made that the willingness of these individuals to remain at large as fugitives under U.S. law suggests that the Antitrust Division is "losing" the extradition war: "[t]he DOJ's goal of prosecuting foreign nationals is becoming elusive."[104] There is, however, another explanation, which we believe is more plausible. The Antitrust Division is being strategic in two respects.

First, uncertainty works in the Division's favor. An individual under an indictment for price-fixing may not be extraditable in his or her country of residence. But not knowing for sure—and thus having to live under the cloud of a U.S. criminal indictment—will increase the individual's incentive to plead guilty, serve a prison term in the United States, and put the matter in the past. Even where there is no possibility of extradition, a U.S. non-national under indictment may need or want to travel internationally, which means facing uncertain, but known, risks that could led to extradition. Again, incentives to plead increase.

Second, the Antitrust Division is in the law enforcement business for the long term. Therefore, it needn't rush things. The indicted individual's cost/benefit assessment may change, and lead to a guilty plea. The legal landscape or public sentiment in the individual's country of residence may change, and lead to extradition (or even to prosecution there). Meanwhile, the U.S. indictment is not going away. For the Division, waiting beats losing. All things come to those who wait.

Endnotes

1. Joel I. Klein, Asst. Att'y General, Antitrust Div., U.S. Dep't of Justice, *The War Against International Cartels: Lessons From The Battlefront* 2, 15 (14 Oct. 1999), http://www.justice.gov/atr/file/518551/download. *See generally* Connor, Foer and Udwin, *Criminalizing Cartels: An American Perspective,* 1 New J. of Eur. Crim. L. 199, 209-10 (Issue 2, 2010) (comparing price-fixing to theft and fraud), http://www.antitrustinstitute.org/sites/default/files/NJECL%202010.pdf.
2. International Competition Network, Working Group on Cartels, *Building Blocks for Effective Anti-Cartel Regimes* 1, 5 (Vol. 1) (2005), http://www.internationalcompetitionnetwork.org/uploads/library/doc346.pdf.
3. For simplicity's sake, we use the term "price-fixing" to include bid-rigging, market allocation and agreed-on output restrictions. The first two involve agreements by competitors not to compete on price, and the third is simply a mechanism to reduce supply by agreement and thereby hike market price. All are typical forms of cartel activity that the U.S. antitrust law (the Sherman Act) prohibits as illegal "*per se*"—that is, without consideration of their market effect.
4. Bill Baer, *Reflections on Antitrust Enforcement in the Obama Administration* 3 (30 Jan. 2014) *("Reflections on Enforcement"),* http://www.justice.gov/atr/file/517761/download. In a recent

department-wide policy statement, the U.S. DOJ has stated that "[o]ne of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing." Memorandum, Sally Quillian Yates, Deputy Att'y General, U.S. Dep't of Justice, *Individual Accountability for Corporate Wrongdoing* 1 (9 Sept. 2015), http://www.justice.gov/dag/file/769036/download.

5. In any given year, the Antitrust Division typically has roughly fifty international cartel investigations going on. Scott D. Hammond, Deputy Asst. Att'y General for Crim. Enforcement, Antitrust Div., U.S. Dep't of Justice, *The Evolution of Criminal Antitrust Enforcement Over the Last Two Decades* 3 (25 Feb. 2010) ("*Evolution of Criminal Enforcement*"), http://www.justice.gov/atr/public/speeches/255515.pdf.
6. *See, e.g., id*., at 7; Belinda A. Barnett, Sr. Counsel to the Deputy Asst. Att'y General for Crim. Enforcement, Antitrust Div., U.S. Dep't of Justice, *Criminalization of Cartel Conduct—The Changing Landscape* 1-3 (3 Apr. 2009) ("*Criminalizing Cartel Conduct*"), http://www.justice.gov/sites/default/files/atr/legacy/2009/07/10/247824.pdf.
7. *See* U.S. Dep't of Justice Antitrust Div. Update Spring 2014, http://www.justice.gov/atr/division-update/2014/criminal-program (in fiscal year 2013, ten foreign nationals were sentenced to prison); U.S. Dep't of Justice Antitrust Div. Update Spring 2011: Criminal Program, http://www.justice.gov/atr/public-documents/division-update-spring-2011/criminal-program-update-2011 (through fiscal year 2010, forty-nine foreign defendants were serving or had served sentences in U.S. prisons for antitrust violations or obstruction charges); Scott D. Hammond, *Evolution of Criminal Enforcement*, note 5 *supra*, at 7; Scott D. Hammond, Deputy Asst. Att'y General for Crim. Enforcement, Antitrust Div., U.S. Dep't of Justice, *Charting New Waters In International Cartel Prosecutions* 1 (2 Mar. 2006) ("*Charting New Waters*"), http://www.justice.gov/atr/file/518446/download.
8. 15 U.S.C. §1, as amended. Price-fixing became a felony antitrust violation in 1974, punishable by up to three years in prison. Since then, the maximum prison term has increased steadily. Before 1974, price-fixing was a misdemeanor, carrying a maximum prison term of one year.
9. Scott D. Hammond, *Evolution of Criminal Enforcement*, note 5 *supra*, at 11. *See also* Bill Baer, *Reflections on Enforcement*, note 4 *supra*, at 3 ("Experience teaches that the threat of prison time is the most effective deterrent against criminal antitrust violations".)
10. Thomas O. Barnett, Asst. Att'y General, Antitrust Div., U.S. Dep't of Justice, *Global Antitrust Enforcement* 4 (26 Sept. 2007) ("*Global Antitrust Enforcement*") (emphasis in original), http://www.justice.gov/atr/file/519231/download; Gerald F. Masoudi, Deputy Asst. Att'y General, U.S. Dep't of Justice, *Cartel Enforcement In The United States (And Beyond)* 5 (16 Feb. 2007) ("*Cartel Enforcement*"), http://www.justice.gov/atr/file/519316/download.
11. *See, e.g.,* Scott D. Hammond, *Charting New Waters*, note 7 *supra*, at 16.
12. No. Cr. 11-00166 (N.D. Cal.) ("*Chen*").
13. Defendant Andrew Chen's Reply to United States' 5 Sentencing Memorandum 1-2, 6, 10, *Chen*, note 12 *supra*, Docket No. 40 (1 Feb. 2013); Transcript 4, *Chen*, note 12 *supra*, Docket No. 45 (filed 15 Feb. 2013).
14. Declaration of Maxwell M. Bleecher ¶ 4, *Chen*, note 12 *supra*, Docket No. 37-6 (filed 30 Jan. 2013).
15. United States' Sentencing Memorandum and Motion for Downward Departure Under U.S.S.G. §5K1.1, at 1, *Chen*, note 12 *supra*, Docket No. 33 (filed 29 Jan. 2013); Transcript, *Chen*, note 12 *supra*, at 6, 10-12, 20.
16. Transcript, *Chen,* note 12 *supra*, at 26, 27-28.
17. *Annual Report on Competition Policy Developments in the United States—2014*, at 7 (16-8 June 2015). *See also* Press Release, U.S. Dep't of Justice, *Current and Former Executives of an Automotive Parts Manufacturer Indicted for Roles in Conspiracy to Fix Prices - Investigation Has Resulted in Charges Against 90 Individuals and Corporations* (21 May 2015), http://www.justice.gov/opa/pr/current-and-former-executives-automotive-parts-manufacturer-indicted-roles-conspiracy-fix-0; Lipman, *Execs Charged For Fixing Spark Plug Prices To Ford, Others*, LAW360 (21 May 2015), http://www.law360.com/articles/658827/print?section=competition.
18. *See* Behre, Briggerman, and Anderson, *DOJ Is Losing The Battle To Prosecute Foreign Executives,* LAW360 (3 Mar. 2015), http://www.law360.com/articles/626482/doj-is-losing-the-battle-to-prosecute-foreign-executives; Krotoski, *Extradition in International Antitrust Enforcement Cases*, THE ANTITRUST SOURCE 2 n.8 (Apr. 2015), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr15_krotoski_4_22f.authcheckdam.pdf.
19. *See, e.g., United States v. Hayes*, 12 mj 3229 (PAC) (JCF), 2015 WL 4620254, at **2-4 (S.D.N.Y. 3 Aug. 2015), *appeal filed*, Docket No. 15-2597 (2d Cir. 3 Aug. 2015).
20. *See, e.g.,* Press Release, U.S. Dep't of Justice, *Former U.K. Rabobank Trader Appears in U.S. Court to Face Libor Interest Rate Manipulation Charges* (20 Mar. 2015), http://www.justice.gov/sites/default/files/atr/legacy/2015/03/20/312654.pdf; Press Release, U.S. Dep't of Justice, *ICAP Brokers Face Felony Charges for Alleged Long-Running Manipulation of LIBOR Interest Rates* (25 Sept. 2013), http://www.justice.gov/opa/pr/icap-brokers-face-felony-charges-alleged-long-running-manipulation-libor-interest-rates.
21. John W. Connor, *Problems With Prison in International Cartel Cases* 27 (20 June 2011) (based on data up to 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2166414 (Open PDF in Browser).
22. If a non-U.S. national is brought to the United States, the individual may assert a "speedy trial" argument in moving to dismiss the case. Although an indicted defendant's absence from the United States does not relieve the government of its obligation to make good-faith efforts to secure the defendant's presence for trial, the government is not required to request extradition if it would be "futile" to do so. *See* Iraola, *Due Process, the Sixth Amendment, and International Extradition*, 90 NEB. L. REV. 752, 774, 784 (2012). Where an individual knows of the indictment and remains outside the United States in a country where extradition is impossible or unlikely, the individual would generally seem more interested in delaying, not expediting, resolution of the pending charges. *See, e.g., United States v. Wanigasinghe*, 545 F.3d 595, 599 (7th Cir. 2008), *cert denied*, 556 U.S. 1112 (2009).
23. *See, e.g.*, *United States v. Hayes*, No. 12 mj 3229 (PAC) (JCF), 2015 WL 4620254 (S.D.N.Y. 3 Aug. 2015) (refusing to dismiss a criminal complaint against a Swiss national, living in Switzerland, for manipulating LIBOR yen transactions), *appeal filed*, Docket No. 15-2597 (2d Cir. 13 Aug. 2015).
24. Robert Burns, *To a Mouse,* in KILMARNOCK VOLUME (1786).
25. Lipman, *DOJ's Baer Promises More Extradition Fights,* LAW360 (15 May 2015), http://www.law360.com/articles/656850/exclusive-doj-s-baer-promises-more-extradupition-fights [sic].
26. U.S. Dep't of Justice, U.S. ATTORNEYS' MANUAL §9-15.100 (International Extradition and Related Matters), http://www.justice.gov/usam/usam-9-15000-international-extradition-and-related-matters. *See also* ABA Section of Antitrust Law, INTERNATIONAL ANTITRUST COOPERATION HANDBOOK 9 (2004) ("INTERNATIONAL COOPERATION"). Note, however, that the U.S. Supreme Court has upheld "non-formal" transfer of individuals to the United States for trial—in other words, abduction—under what is often referred to as the *Ker-Frisbie* doctrine. *See, e.g.*, *United States v. Alvarez-Machain*, 504 U.S. 655, 657 (1992) ("The issue in this case is whether a criminal defendant, abducted to the United States from a nation with which it has an extradition treaty, thereby acquires a defense to the jurisdiction of this country's courts. We

hold that he does not, and that he may be tried in federal district court for violations of the criminal law of the United States"). *But see United States v. Toscanino*, 500 F.2d 267, 275 (2d Cir. 1974) ("We view due process as now requiring a court to divest itself of jurisdiction over the person of a defendant where it has been acquired as the result of the government's deliberate, unnecessary and unreasonable invasion of the accused's constitutional rights").

27. *See generally* list of countries with an extradition treaty with the United States, http://www.state.gov/documents/organization/71600.pdf.
28. *See generally* 18 U.S.C. §§ 3181 *et seq.*; U.S. Dep't of Justice, U.S. Attorneys' Manual, note 26 *supra*, §§ 9-15.100 *et seq.*, http://www.justice.gov/usam/usam-9-15000-international-extradition-and-related-matters#9-15.700; U.S. Dep't of Justice, U.S. Attorneys' Manual, note 26 *supra*, *Criminal Resource Manual* § 612, http://www.justice.gov/usam/criminal-resource-manual-612-role-department-state-foreign-extradition-requests.
29. *Hilton v. Kerry,* 754 F.3d 79, 83 (1st Cir. 2014) (internal quotations and citations omitted).
30. *See generally id.; United States v. Kin-Hong*, 110 F.3d 103 (1st Cir. 1997); 18 U.S.C. § 3186.
31. ABA Section of Antitrust Law, International Cooperation, note 26 *supra*.
32. Article II, Treaty of Extradition Between the United States of America and the United States of Brazil (in force 17 Dec. 1964), 15 UST 2093.
33. *See* ABA Section of Antitrust Law, International Cooperation, note 26 *supra*, at 65.
34. *Report on International Extradition Submitted to the Congress Pursuant to Section 211 of the Admiral James W. Nance and Meg Donovan Foreign Relations Authorization Act, Fiscal Years 2000 and 2001 (Public Law 106-113)* 1-2 (27 Mar. 2000).
35. *Id.* at 2.
36. *Id.*
37. ABA Section of Antitrust Law, International Cooperation, note 26 *supra*, at 65-66.
38. *Id.* at 66.
39. *Id.*
40. ABA Section of Antitrust Law, International Cooperation, note 26 *supra*, at 10 (emphasis added).
41. Article III, Treaty of Extradition Between the United States of America and the United States of Brazil (in force 17 Dec., 1964), 15 UST 2093.
42. Michael John Garcia and Charles Doyle, *Extradition to and from the United States: Overview of the Law and Recent Treaties* 9-10 (Cong. Res. Serv. 2010).
43. Lipman, *DOJ Official Warns Extradition" "Safe Havens" Fading*, Law360 (5 June 2014), http://www.law360.com/articles/545218/doj-official-warns-extradition-safe-havens-fading.
44. *See generally* Belinda A. Barnett, *Criminalizing Cartel Conduct*, note 6 *supra*, at 4-8.
45. *See generally* Shaffer and Nesbitt, *Criminalizing Cartels: A Global Trend?* 4, 26-29 (Table 1) (2015) ("*Criminalizing Cartels*"), http://ssrn.com/abstract=1865971 (Open PDF in Browser); Scott D. Hammond, *International Developments in Anti-Cartel Enforcement* (12-13 Mar. 2015) (detailing recent antitrust enforcement, including criminal prosecution, worldwide), http://www.nysba.org/Sections/International/Events/2015/Zurich_Regional_Meeting/Coursebook/Thursday_-_Antitrust/Scott_Hammond_powerpoint_presentation.html.
46. Shaffer and Nesbitt, *Criminalizing Cartels*, note 45 *supra*, at 9, 17 (footnotes omitted).
47. *See, e.g.*, Basic Law for the Federal Republic of Germany [*Grundgesetz*], Article 16 (2), 29 July 2009, http://www.iuscomp.org/gla/statutes/GG.htm#16; Article 8 of the Extradition Law of the People's Republic of China, http://www.gov.cn/english/laws/2005-09/22/content_68710.htm; Article 4 of the Law of Extradition of the Republic of China, http://law.moj.gov.tw/Eng/news/news_detail.aspx?id=192; Article 2, Law of Extradition of Japan, http://www.moj.go.jp/ENGLISH/information/loe-01.html. *See also* Joshua and Camesasca, *An Antitrust NATO—the DOJ's "Foreign Policy" in the War Against International Cartels*, European Antitrust Rev. (2006), http://www.howrey.com/docs/AnAntitrustNATO_GCREuropeanATReview.pdf.
48. *United States v. Valentine*, 81 F.2d 32, 35 (2d Cir.), *affirmed sub nom. Valentine v. United States ex rel. Neidecker*, 299 U.S. 5 (1936).
49. *Id.*, 299 U.S. at 18.
50. 18 U.S.C. § 3196: "If the applicable treaty or convention does not obligate the United States to extradite its citizens to a foreign country, the Secretary of State may, nevertheless, order the surrender to that country of a United States citizen whose extradition has been requested by that country if the other requirements of that treaty or convention are met."
51. Article 3 of the Extradition Treaty between France and the United States of America, 23 April 1996, provides: "There is no obligation upon the Requested State to grant the extradition of a person who is a national of the Requested State, but the executive authority of the United States shall have the power to surrender a national of the United States if, in its discretion, it deems it proper to do so." *See* U.S.-France., Art. 3, S. Treaty Doc. No. 105-13 (1996).
52. Article VII, Treaty of Extradition Between the United States of America and the United States of Brazil (in force 17 Dec. 1964), 15 UST 2093. This provision is subject to an interpretation: "The Contracting Parties are not obliged by this Treaty to grant extradition of their nationals. However, if the Constitution and laws of the requested State do not prohibit it, its executive authority shall have the power to surrender a national if, in its discretion, it be deemed proper to do so." Article I, Additional Protocol to the Treaty of Extradition of January 13, 1961, Between the United States of America and the United States of Brazil (in force 17 Dec. 1964), 15 UST 2093.
53. *See, e.g.,* Extradition Treaty between the United States and the Republic of Korea, Art. 3, S. Treaty Doc. 106-2 (in force 20 Dec. 1999): "1. Neither Contracting State shall be bound to extradite its own nationals, but the Requested State shall have the power to extradite such person if, in its discretion, it be deemed proper to do so. 2. If extradition is refused solely on the basis of the nationality of the person sought, the Requested State shall, at the request of the Requesting State, submit the case to its authorities for prosecution." *See also* Extradition Treaty between the United States and Poland, Art. 4, S. Treaty Doc. 105-14 (in force 1 Feb. 2010) (same).
54. *See, e.g., United States v. Kin-Hong*, 110 F.3d 103, 116 (1st Cir. 1997).
55. *See* McGovern, Toh and Jo, *Extradition of Japanese Nationals: A Growing Threat in U.S. Prosecutions of International Cartels?* 12-14 (Apr. 2015) ("*Extradition of Japanese Nationals*") (discussing recent criminal cases in Japan), https://www.ropesgray.com/~/media/Files/articles/2015/April/20150402-Extradition-of-Japanese-Nationals.ashx (download), *published* in 43 J. Japan. Inst. of Inter. Bus. Law (No.3 Mar 2015). The Japan Fair Trade Commission (JFTC) investigates potential antitrust violations, and can submit cases for criminal prosecution. *See* JFTC, Press Releases for 2002-2015, http://www.jftc.go.jp/en/pressreleases/index.html, *linking to Enforcement of the Antimonopoly Act in FY2013* (28 May 2014) (In fiscal year 2013, the JFTC filed criminal accusations with the Public Prosecutor General against eight companies and eight employees.); *Enforcement of the Antimonopoly Act in FY2012* (29 May 2013) (In fiscal year 2012, the JFTC filed a criminal accusation with the Public Prosecutor General against seven individuals and three

companies in connection with a price-fixing cartel by bearing manufacturers.). The JFTC also issues cease and desist orders against price-fixing and bid-rigging cartels. *See Enforcement of the Antimonopoly Act in FY2014* (27 May 2015) (In fiscal year 2014, the JFTC issued two cease and desist orders in bid-rigging cases, and five in connection with price-fixing cartels.).

56. Lipman, *DOJ Official Warns Extradition 'Safe Havens' Fading*, note 43 *supra*.
57. *See generally* McGovern, Toh and Jo, *Extradition of Japanese Nationals*, note 55 *supra*.
58. Andreas Stephan, *Survey of Public Attitudes to Price Fixing in the UK, Germany, Italy and the USA* 17 (2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2642181 (Open PDF in Browser).
59. *Id.* at 16.
60. *Id.* at 19.
61. Article IV, Treaty of Extradition Between the United States of America and the United States of Brazil (in force 17 Dec. 1964), 15 UST 2093.
62. Scott D. Hammond, *Charting New Waters*, note 7 *supra*, at 7-8.
63. *See* United States Sentencing Memorandum Re Homy Hong Ming Hsu 2, Docket No. 274 (filed 15 Jan. 2013), *United States v. Eagle Eyes Traffic Industrial Co*., No. 11-cr-00488-RS (N.D. Cal.) ("*Eagle Eyes*").
64. United States' Opposition to Defendant Homy Hong-Ming Hsu's Motion to Modify Conditions of Pretrial Release 2, *Eagle Eyes*, note 63 *supra*, Docket No. 48 (filed 18 Jan. 2012).
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> The Division has uncovered cartel activity in conjunction with crimes such as mail and wire fraud, bribery, money laundering, and tax offenses, to name just a few. Antitrust prosecutors should have the power and the inclination to pursue a cartelist for each and every criminal violation, both to vindicate such proscriptions on their own merits and to induce cooperation against other members of the cartel.

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***Jon Secada, *I'm Never Too Far Away*, on I'M NEVER TOO FAR AWAY (Secada Prod. 2012) ("Even when it seems I'm gone/On those nights when you're alone/I'm never too far away"**

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Anti-Cartel Enforcement in Brazil: Status Quo and Trends

By Ana Paula Martinez and Mariana Tavares de Araujo

I. Introduction

Hardcore cartel prosecution has quickly evolved in Brazil over the past decades. From 1994 to 2003, Brazil's antitrust authorities focused primarily on merger reviews, and substantial resources were devoted to the review of competitively innocuous mergers. In 2003, the antitrust authorities established a hierarchy of antitrust enforcement that placed anti-cartel enforcement as top priority. From 2003 to 2008, Brazil's antitrust authorities implemented a leniency program and built a network with criminal prosecutors that allowed them to tap into sophisticated investigative techniques and secure criminal sanctions, including jail sentences, for cartelists. Following that, CADE concluded the first high profile cartel cases and spent significant resources on public outreach on harmful effects of cartels. A more recent phase began in May 2012, when the current antitrust law entered into force and introduced key legal changes, including revised administrative and criminal sanctions to cartel conduct.

This article provides an overview of anti-cartel enforcement in Brazil and discusses current trends.

II. Overview of the Anti-cartel Enforcement

A. Administrative Enforcement

At the administrative level, antitrust law and practice in Brazil is governed by the recently enacted Law 12,529/2011, which entered into force on 29 May 2012 and replaced Law 8,884/1994.[1] The new antitrust law has consolidated the investigative, prosecutorial and adjudicative functions into one independent agency: the Brazilian Antitrust Authority—CADE. CADE's structure includes a court comprised of six Commissioners and a Chairman; a Directorate-General for Competition—DG; and an Economics Department. The DG is the chief investigative body in matters related to anticompetitive practices. CADE's tribunal is responsible for adjudicating the cases investigated by the DG—all decisions are subject to judicial review. There are also two independent offices within CADE: CADE's Legal Services, which represents CADE in court and may render opinions in all cases pending before CADE; and the Federal Prosecution Office, which may also render legal opinions in connection with cases pending before CADE.

In Brazil, the Anglo-American concept of binding judicial precedent (*i.e.*, *stare decisis*) is virtually non-existent, which means that CADE's Commissioners are under no obligation to follow past decisions in future cases. Under CADE's internal regulations, legal certainty is only achieved if CADE rules in the same way at least ten times, after which they codify a given statement via the issuance of a binding statement. To date, CADE has issued nine binding statements, all but one related to merger review.[2]

Article 36 of Law 12,529/2011 sets forth the basic framework for anticompetitive conduct in Brazil. Article 36 addresses all types of anticompetitive conduct other than mergers. The law did not change the definition or the types of anticompetitive conduct that could be prosecuted in Brazil under the previous law. The law prohibits acts "whose object or effect is to" (i) limit, restrain or, in any way, adversely affect open competition or free enterprise; (ii) control a relevant market of a certain good or service; (iii) increase profits on a discretionary basis; or (iv) engage in abuse of monopoly power. However, Article 36 specifically excludes the achievement of market control by means of "competitive efficiency" from potential violations. Under Article 2 of the law, practices that take place outside the Brazilian territory are subject to CADE's jurisdiction, provided they produce actual or potential effects in Brazil.

The law was broadly drafted to apply to all forms of agreements and exchange of sensitive commercial information, formal and informal, tacit or implied. Cartels, as an administrative offense, may be sanctioned by CADE—fines[3] against the companies may range from 0.1 percent to twenty percent of the company's or group of companies' pre-tax turnover in the economic sector affected by the conduct, in the year prior to the beginning of the investigation. To date, CADE has not issued secondary legislation clarifying in which cases the agency will resort to the group's sales instead of taking into account only the turnover of the defendant. CADE's Resolution No. 3/2012 lists one hundred forty-four "fields of activities" to be considered for the purposes of calculating the fine under the new law. CADE may resort to the total turnover, whenever information on sales derived from the relevant "sector of activity" is unavailable. Moreover, the fine may be no less than the amount of harm resulting from the conduct. CADE has seldom resorted to this provision when determining fines and, when it has, the fine imposed was less than the equivalent to the maximum percentage of the defendant's turnover allowed by the law.

Officers and directors[4] liable for unlawful corporate conduct may be fined an amount ranging from one percent to twenty percent of corporate fines. Unlike the previous law, CADE must currently determine fault or negligence by the directors and officers in order to find a violation. Other individuals, business associations and other entities that do not engage in commercial activities may be fined from approximately BRL 50,000.00 to BRL 2 billion.[5]

According to Article 45 of Brazil's antitrust law, the following shall be taken into account by CADE when setting fines: (i) level of seriousness of the infringement; (ii) good faith of the defendant; (iii) gain obtained or sought by the defendant; (iv) whether the conduct has been consummated; (v) level of actual or potential harm to competition, Brazilian economy, consumers or third parties in general; (vi)

detrimental economic effects caused by the conduct in the market; (vii) economic situation of the defendant; and (viii) recidivism. Finally, fines must be doubled if the defendant was already sanctioned by CADE for antitrust offenses in the last five years.

Apart from fines, CADE may also: (i) order the publication of the decision in a major newspaper, at the wrongdoer's expense; (ii) debar wrongdoers from participating in public procurement procedures and obtaining funds from public financial institutions for up to five years; (iii) include the wrongdoer's name in the Brazilian Consumer Protection List; (iv) recommend tax authorities to block the wrongdoer from obtaining tax benefits; (v) recommend the intellectual property authorities to grant compulsory licenses on patents held by the wrongdoer; and (vi) prohibit individuals from exercising market activities on his or her behalf or representing companies for five years.[6] As for structural remedies, under the law CADE may order a corporate spinoff, transfer of control, sale of assets or any measure deemed necessary to cease the detrimental effects associated with the wrongful conduct.

to the antitrust authorities, CADE's wide-ranging enforcement of such a provision may prompt judicial appeals.

As for law enforcement, the prosecution of cartels has been a top priority in Brazil since 2003. Approximately fifty leniency agreements have since been signed, the majority with alleged members of international cartels, and more than four hundred search warrants have been served since 2003.

As a result of the use of more aggressive investigative tools, CADE has been imposing extremely high fines on both companies and individuals found liable for hardcore cartel conduct. The record fine imposed by CADE in connection with a cartel case was of roughly US$ 1 billion, in 2014. The level of fines imposed is considerably higher when the case is supported by direct evidence (average of fifteen percent of the annual gross sales of the defendant in cases with direct evidence, as opposed to an average of one percent of the annual gross sales of the defendant in cases without direct evidence). The table below provides a summary of the main cartel cases sanctioned by CADE and the duration of the investigation:

Case	Filing of the Investigation–Adjudication	Fines (USD)[7]	% of the Total Turnover[8]
Marine Hose	2007-2015	5 million	Not available
Hospitals	2000-2015	3.8 million	Not available
Metal Detector Security Doors	2008-2014	4.4 million	Not available
Cement	2006-2014	1.08 billion	15-20% (30-40%)[9]
LPG Distribution	1997-2014	3.7 million	Not available
Air Freight	2007-2014	29 million	Not available
Copyright Collection	2010-2013	12.6 million	Not available
Air Cargo	2006-2013	100 million	Not available
Hydrogen Peroxide	2004-2012	47 million	Not available
Industrial Gases	2003-2010	800 million	25% (50%)[10]
Steel Bars	2000-2005	120 million	7%
Crushed Rock	2002-2005	21 million	15-20%
Flat Steel	1996-1999	19 million	1%
Security Services	2003-2007	15 million	15-20%
Vitamins	1999-2007	5.7 million	20%
Sand Extractors	2006-2008	1.0 million	10-22.5%

The law also includes a broad provision allowing CADE to impose any "sanctions necessary to terminate harmful anticompetitive effects," whereby CADE may prohibit or require a specific conduct from the wrongdoer. Given the quasi-criminal nature of the sanctions available

In addition to the cases described above, there are over one hundred ongoing cartel investigations pending before CADE, including cases involving markets such as TFT-LCD, CDT, CPT, air freight forwarders, DRAM, ODD, underground cables, underwater cables, polymers, salt

and silicate, capacitors, several auto-parts cases, most of them initiated through leniency filings.

Brazil's Settlement Program for cartel investigations was introduced in 2007, through an amendment to the previous antitrust law.[11] In March 2013, CADE introduced revised requirements for settlements, according to which all defendants in cartel cases must now acknowledge their involvement in the activity under investigation.[12] The provision does not refer to a "confession" and the requirement "to acknowledge participation" may allow for certain flexibility with respect to its terms, compared to a strict "confession" requirement.[13] Also, under the current rules, meaningful cooperation is mandatory in all cartel cases; and the assessment on whether the parties have or not fulfilled the settlement conditions will only take place when CADE issues a final ruling on the case.[14]

Settlement proposals may be accepted at any stage of the investigation, even after DG has concluded its investigation and while CADE's Court reviews the case. Defendants may only try to settle once ("one-shot game"). The negotiation process may be confidential, at CADE's discretion. A scale of discounts is applicable to the settling sum defendants that wishing to settle must pay.[15]

The table below provides a summary of the main cartel cases settled by CADE and the duration of the investigation:

Case	Filing of the Investigation–Settlement	Settlement (USD)[16]
CRT (CPT and CDT)	2009-2015	14.4 million
Medical and Hospital Services	2000-2015	1.4 million
DRAM	2010-2014/2015	945,000
Air and Maritime Freight	2009-2014/2015	8.5 million
IT Services	2012-2014	400,000
Coatings and Composites Resins	2014	12.4 million
LCD	2008-2014	15 million
LPG Distribution	2005-2013/2014	9.7 million
Laundry Services	2008-2014	1 million
Ambulances	2005-2014	12.5 million
Underground/ Underwater Cables	2010-2013	480,000
Air Cargo	2006-2013	5.7 million
Marine Hose	2007-2008/2013	10 million
IT Services	2005-2011	16 million
Compressors	2009-2009	35 million
Plastics Bags	2006-2008	8 million
Cement	2006-2007	15.5 million

Finally, Brazil has been increasing its cooperation with foreign antitrust agencies in cartel cases. Brazil's antitrust authorities have executed cooperation agreements with the U.S. Department of Justice, the European Commission, Argentina, Canada, Chile, China, Equator, France, Peru, Portugal and Russia.[17] The Brazilian authorities have requested the assistance of foreign authorities on several occasions to conduct an investigation and, more recently, with the increasing number of dawn raids, foreign authorities and injured third parties have become interested in evidence seized in Brazil.

B. Criminal Enforcement

Apart from being an administrative offense, cartel is also a crime in Brazil, punishable by criminal fine and imprisonment from two to five years. According to Brazil's Economic Crimes Law, Law 8,137/1990, this penalty may

be increased by one-third to one-half if the crime causes serious damage to consumers, is committed by a public servant, or relates to a market essential to life or health. Also, Law 8,666/1993 specifically targets fraudulent bidding practices, punishable by criminal fine and imprisonment from two to four years.

Brazilian federal and state prosecutors are in charge of criminal enforcement in Brazil, and act independently from the administrative authorities. Also, the police (local or the federal police) may start investigations of cartel conduct and report the results of their investigation to the prosecutors, who may or may not file criminal charges against the reported individuals.

The administrative authorities (former SDE and current DG) have set a framework for the relationship with the criminal authorities, which reduces legal uncertainty and creates a healthy competition among the different criminal enforcement authorities. Each one of the twenty-six Brazilian states has a State Prosecution Office. Early in its efforts to increase cooperation, SDE established a relationship with prosecutors in São Paulo and encouraged the creation of a special unit within the Prosecution Office of the State of São Paulo—named *GEDEC*—to investigate cartels and cooperate with the competition agencies in joint criminal and administrative investigations.

The cooperation experience with São Paulo was used as a reference point to foster relationships with other prosecutors. In December 2007, the Federal Police established an "Intelligence Center for Cartel Investigations" to advance cooperation efforts in joint criminal and administrative investigations of cartels. Along the same line, the Prosecution Offices of the states of Paraíba, Rio de Janeiro, Santa Catarina, Amazonas, Minas Gerais, Rio Grande do Norte, and Piauí have organized special anti-cartel units, with the support of the Brazilian Ministry of Justice.

In October 2009, the Ministry of Justice launched the National Anti-Cartel Strategy, a permanent forum comprised of both criminal and administrative antitrust authorities to discuss the implementation of the country's criminal anti-cartel laws. In November 2013, CADE executed a cooperation agreement with the Federal Police setting the framework for cooperation under the new antitrust law.

III. Trends

A. Increased Criminal Prosecution

More than four hundred executives are facing criminal proceedings in Brazil for alleged cartel offenses and there is a final criminal decision sentencing nineteen executives to pay a criminal fine for cartel offenses.[18] In 2014, a criminal court sentenced one defendant in an international cartel case to serve ten years and three months in prison, and also determined the payment of damages in the amount of approximately US$ 130 million.[19] Even though the maximum statutory prison term for cartel offenses is five years, the judge found the defendant guilty on multiple counts (collusion and criminal conspiracy). Another twenty-one executives were sentenced to serve jail terms of two and a half to five years and three months for cartel offenses.

Although there are appeals pending review against such judicial decisions, the decisions indicate that an earlier trend of settling criminal cases under specific conditions[20] (*e.g.,* payment of a criminal fine and appearance every other month before a judge to state that the person is not involved in cartel conduct) seems to have been overturned. These decisions also reveal that criminal courts now regard cartel conduct as a serious violation that justifies the imposition of jail sentences.

B. Imposition of Non-Pecuniary Sanctions

In most cartel cases adjudicated in recent years, in addition to fines, CADE had been primarily ordering companies to publish the guilty verdicts in a major newspaper. More recently, CADE has also recommended that tax authorities prohibit wrongdoers from obtaining tax benefits and determined the inclusion of the companies' names in the Brazilian Consumer Protection List.

In 2014, CADE's Court delivered a final ruling on the cement cartel investigation, which had been in progress since 2006. In January, the Reporting Commissioner had recommended that the six companies, six individuals and three industry associations be found guilty of collusion. The judgment came to an end in May and sanctions included a record fine of over US$ 1 billion, plus other ancillary sanctions, such as the divestiture of assets and a ban on carrying out transactions in the cement and concrete industry for five years, subject to certain conditions. It was the first time that CADE resorted to structural sanctions, which is relatively unusual in cartel cases. The judgment's reasoning and the Commissioners' further public declarations suggest that this case may not have been an outlier and that CADE would consider adopting structural remedies and M&A bans in cartel investigations, particularly in markets in which the alleged conspiracy reportedly went on for a long period of time.

Furthermore, during its last adjudication session in 2014, CADE issued guilty verdicts in connection with three bid-rigging cartel investigations in the markets for metal detector security doors; orthopedic orthotics and prosthesis products; and painting and plumbing materials. In all such cases, apart from the imposition of fines, defendants were also debarred from public procurement for a five-year period. CADE had previously imposed this sanction on very few occasions (*e.g.,* cartel on security services adjudicated in 2007).

CADE's rulings in these cases indicate that high fines against companies and decisions in newspapers are no longer the only tool it will resort to in order to severely punish cartel conduct.

C. Increased Number of Settlements and Interface with Leniency

Notwithstanding the pros and cons of settling, the fact is that since 2013, CADE has executed approximately sixty settlements, mostly in connection to cartel investigations. From December 2014 to February 2015 alone, the Court approved thirteen settlements with defendants in domestic and international cartel cases.[21]

The current enforcement practice shows that CADE has been open to negotiate settlements at all stages of the proceedings. Accordingly, three of the aforementioned settlements were entered into only a few months after dawn raids had been conducted in connection with the case.[22] Conversely, in 2014, CADE also settled a cartel investigation after it had already been reviewed by all advisory bodies (the DG, CADE's Legal Services and the Federal Prosecution Office), which had recommended that the defendants be found guilty.

On the interface of settlements with leniency, even after the 2013 regulation, the "umbrella" provision, which shields all employees and former employees of the settling cartel participant from administrative liability, even if they are not a party to the settlement with CADE, is still only available for settlements and not for leniency agreements, which may discourage filings for leniency. On the other hand, there is still one major advantage of leniency over settlements for individuals: while leniency applicants address administrative and criminal liabilities together (therefore being entitled to criminal immunity), defendants interested in settling an ongoing case must deal with the administrative and criminal investigations separately, and criminal immunity is no longer available.

D. Increased Private Damage Claims

Private antitrust enforcement in Brazil has been on the rise over the past five years. This may be due to such reasons as the global trend of antitrust authorities encouraging damage litigation by potential injured parties; the growing number of infringement decisions issued by CADE;[23] and the increasing general awareness of antitrust law in Brazil. In Brazil, cartel members, with no exception to the leniency applicant, are jointly and severally liable for damages caused by their illegal antitrust activity, *i.e.,* each cartel member may be held liable for the entire cartel-related damage.[24] Such joint and several liability has not significantly deterred parties from applying for leniency until recent years. The scenario began changing in 2010, when CADE sent a copy of its decision finding a cartel violation in the market for industrial and hospital gases to potentially injured parties for the first time, so that such parties could seek damages from the relevant wrongdoers.[25] That action may have tipped the scale for private claims in Brazil, with a potential adverse effect for leniency. For example, in 2013, the State of São Paulo had already filed a civil claim against a leniency applicant to recover overspent money due to the existence of alleged bid rigging in connection with the construction and maintenance of São Paulo's subway (the judge later required the government to amend the claim to also include the other co-conspirators). Brazil's Congress must therefore pass new legislation excluding a leniency applicant from joint and several liability with its co-conspirators to preserve the incentives for companies to come forward and self-report antitrust offenses.

Another important aspect regarding the interplay between cartel investigations and private claims is related to the level of protection offered by CADE to documents submitted by leniency applicants. The risk of premature disclosure of leniency documents, especially in view of cross-jurisdictional cases,[26] and the rise of private antitrust enforcement, may deter a cartel member from applying for leniency in Brazil. Even though CADE has been adopting a number of measures to ensure that leniency documents and the identity of the leniency applicant remain confidential throughout the investigation, it is still unclear how it will treat leniency documents following the adjudication of the case. A 2013 incident involving the leakage of the identity of a leniency applicant at an early stage of an investigation on alleged bid rigging in connection with the construction and maintenance of São Paulo's subway cast doubts on the ability of the authorities involved to comply with the confidentiality assurances given to the leniency applicant.

E. Recurrent Use of Borrowed Evidence

The reforms that extended CADE's investigative tools have not eliminated the antitrust authority's need to use borrowed evidence when conducting some of its investigations. Indeed, Brazilian courts have consistently allowed administrative authorities to borrow evidence gathered in criminal proceedings, as long as the original diligence was authorized by a judge and due process of law are respected. According to the case law of Brazilian higher courts, the evidence may be shared with other authorities even if the original proceeding—in which the evidence was gathered—has different defendants.

At the end of 2014, CADE convicted a fuel distributor for influencing its retailers to standardize their commercial practices in two cities of the State of São Paulo, and did so relying on borrowed evidence from labor proceedings.[27] More cases where the authority uses evidence gathered on other instances are likely, including the major investigation of alleged bid rigging in the construction industry, which included dawn raids that did not count on CADE's active participation.

However, relying on other authorities for evidence also exposes CADE to occasional flaws in wiretappings and dawn raids. For instance, the defense of individuals under investigation in criminal proceedings related to alleged bid rigging in the construction industry has focused on attempting to have the evidence declared illegal. If that happens to be the outcome, part of the borrowed material will not be available to the antitrust authority. In this sense, in May 2014, a federal judge nullified the fines of over half

a billion reais CADE had imposed on an industrial gas manufacturer (Air Products) in 2010, sustaining the allegation that the supporting evidence, which had been borrowed by the criminal authorities, was illegally obtained.

F. Need for Increased Cooperation with Anticorruption Authorities

The fight against corruption has been on the rise in Brazil, especially following the enactment of Brazil's Clean Companies Law in 2013, Law 12,846/2013, and the recent so-called Car Wash investigation.[28]

Given that some cartel cases, in particular those involving bid rigging, also encompass corrupt practices, it is crucial for CADE and the anticorruption authorities to cooperate closely to ensure consistency and preserve the incentives for the leniency program. Article 87 of Brazil's antitrust law provides that successful fulfillment of a leniency agreement insulates cooperating parties from criminal liability for cartel offenses under Brazil's Economic Crimes Law,) Law 8,137/1990, and for other criminal offenses perpetrated in connection with the antitrust violation, such as fraudulent bidding practices, Law 8,666/1993; and conspiracy to commit crimes condemned by Article 288 of Brazil's Criminal Code.[29] Although the law generally refers to "crimes directly related to the cartel activity, such as the ones listed in Law 8,666/1993 and Article 288 of Brazil's Civil Code," some prosecutors have already stated that a leniency letter signed with CADE may only protect leniency recipients from criminal conviction regarding the offenses explicitly mentioned by the law. It is therefore necessary for the criminal authorities to align with CADE on what should be the approach for a given corruption case in order to preserve the incentives for leniency and reduce legal uncertainty.

The same concern applies to other corrupt practices that could potentially amount to an administrative offense perpetrated in connection with the antitrust violation. The only difference is that there is no provision in Brazil's antitrust law on the possibility of obtaining immunity for such offenses as a result of a leniency letter executed with CADE. For example, if a cartel participant bribes a public official to direct contracts to the designated winning bidders in connection with a bid-rigging arrangement, the company would also be subject to a fine of up to twenty percent of the company's gross sales in the year prior to the initiation of the investigation under Brazil's Clean Companies Law, Law 12,846/2013, apart from other sanctions that may be imposed by CADE. A leniency applicant would have to engage in discussions with both CADE and the highest authority of the specific government entity under whose jurisdiction the alleged corruption practice took place (at the Executive, Legislative or Judicial branches), to try to ensure a more lenient treatment. According to Brazil's Clean Companies Law, self-disclosure of corrupt practices and illegal conduct in public tenders by corporations may result in a reduction of up to two-thirds of the applicable fine and immunity against other sanctions. Unlike CADE's leniency program, the Clean Companies Law does not extend the benefits of its whistleblowers' program to the individuals involved, who may still be held liable under Brazil's Criminal Code and other laws.

IV. Conclusion

Administrative and criminal prosecution against hardcore cartels have been on the rise since 2003, when the first dawn raids were conducted and the first leniency agreement was executed. Since then, Brazilian antitrust authorities have lived up to their promise to increase enforcement and step up sanctions against cartels. In the coming years, more individuals are expected to be sentenced to serve jail time for engaging in cartel conduct, and CADE is expected to impose ever-higher fines and other severe ancillary sanctions against corporations and individuals, contributing to the attractiveness of Brazil's leniency program.

The accomplishments of Brazil's anti-cartel enforcement program show that Brazil's antitrust authorities have scored more hits than misses in this process. Nevertheless, it is still a work in progress and in order to ensure continuous development, CADE needs to be ready to deal with many complex issues, some of which may depend on additional changes to relevant laws and current policies.

Endnotes

1. Prior to Law 12,529/2011, there were three competition agencies in Brazil: the Secretariat of Economic Monitoring of the Ministry of Finance (SEAE); the Secretariat of Economic Law of the Ministry of Justice (SDE); and the Administrative Council for Economic Defense (CADE). SDE was the chief investigative body in matters related to anticompetitive practices, and issued non-binding opinions in connection with merger cases. SEAE also issued non-binding opinions related to merger cases and issued opinions in connection with anticompetitive investigations. CADE was structured solely as an administrative court, which made final rulings in connection with both merger reviews and anticompetitive practices.
2. The exception is Binding Statement No. 7, whereby it is an antitrust violation for a physicians' cooperative with monopoly power to prevent affiliated physicians from being affiliated with other physicians' cooperatives and medical insurance plans.
3. Individuals and companies may also be fined (i) for refusing or delaying the provision of information, or for providing misleading information; (ii) for obstructing an on-site inspection; or (iii) for failing to appear or failing to cooperate when summoned to provide oral clarification.
4. Under Article 32 of the law, directors and officers may be held jointly and severally liable with the company for anticompetitive practices perpetrated by the company. Considering the strict sanctions that have been imposed upon legal entities by CADE to date, this provision has nearly been forgotten, since virtually no individual would be in a position to be held liable for the sanctions imposed against the company.
5. Approximately US$ 17,482.00 to US$ 699,300,000.00 (exchange rate of US$ 1.00 = BRL 2.86).
6. The idea behind this provision was to deal with situations in which CADE debarred wrongdoers from participating in public procurement procedures and from obtaining funds from public financial institutions for up to five years. To avoid this penalty, the parties simply set up a new company and resumed activities in the same sector without being subject to the restrictions imposed by CADE's decision.
7. Exchange rate of US$ 1.00 = BRL 2.86.

8. Under the previous antitrust law, fines for corporations for anticompetitive conduct ranged from one percent to thirty percent of a company's pre-tax sales in the year preceding the filing of the proceedings.
9. The fine of one of the defendants was doubled for recidivism.
10. The fine of one of the defendants was doubled for recidivism.
11. The 2007 Settlement Regulation also included rules on settlements for other types of anticompetitive conduct, which had been in place since 1994.
12. Until March 2013, such requirement only applied to cases initiated through a leniency agreement.
13. This may also prevent individuals from settling with CADE, since "acknowledging participation" in connection with the administrative investigation may compromise their respective defense in parallel criminal investigations and may result in conflict of interest between the company and its employees, should the company choose to settle the case with CADE, even if individuals decide otherwise. This situation is specific to Brazil, where it is possible to have parallel enforcement initiatives taken by administrative and criminal authorities against the same individuals, for the same facts.
14. Cooperation may include submitting documents and information in the possession, custody or control of the settling party; using the settling party's best efforts to secure the cooperation of current and former employees; and appearing for interviews, court appearances and trials.
15. Reductions may vary between (i) thirty percent and fifty percent for the first party to propose the settlement; (ii) twenty-five percent to forty percent for the second in; and (iii) up to twenty-five percent to the other parties that follow. For settlement proposals submitted after the DG has concluded the investigation, reductions are limited to fifteen percent. Theoretically, based on the fine that would apply to the parties under investigation for cartel, such discounts are supposed to vary according to (i) the order in which the parties come forward; and (ii) the extent and usefulness of what the parties provide in cooperation with the authorities. Since CADE is yet to issue sentencing guidelines, and case law for hard core cartel cases is still limited, these standards may be of little help. In practice, CADE has required defendants to pay amounts ranging from five percent to fifteen percent of the sales generated by the party in the year prior to the investigation, in order to settle a case.
16. Exchange rate of US$ 1.00 = BRL 2.86.
17. In February 2009, Brazil's administrative and criminal authorities launched the first simultaneous dawn raid in connection with an international cartel investigation, together with the U.S. Department of Justice and the European Commission.
18. Foreign executives may also be subject to Brazil's criminal system.
19. Exchange rate of US$ 1.00 = BRL 2.86.
20. The ability to settle a criminal investigation for cartel conduct is disputable following the introduction of changes to Brazil's Economic Crimes Law, which became effective in May 2012. The new antitrust law modified the criminal sanctions applicable to anticompetitive conduct. The previous provision of the Economic Crimes Law sets forth jail terms of two to five years or the payment of a criminal fine. The new law determines that anticompetitive behavior may be punished with a jail term of two to five years plus the payment of a criminal fine. Since the minimum criminal sanction is now a two-year jail sentence (and not a fine), some prosecutors understand that individuals are no longer allowed to settle criminal investigations. Such provisions only apply to acts perpetrated on or after 29 May 2012.
21. International cartel cases include DRAM, products for the transmission and distribution of electric energy, and air and maritime cargo freight CDT, and CPT.
22. Settlements in the coatings and composites resins investigation in December 2014 (*See* Cases No. 08700.004496/2014-19, 08700.004627/2014-68 and 08700.005159/2014-49).
23. As it would be expected, follow-on litigation depends on the strength of CADE's case. CADE's decisions lack collateral estoppel effect, and even after a final ruling has been issued by the agency, all the evidence of the administrative investigation may be re-examined by the judicial courts, which could potentially lead to two opposite conclusions (administrative and judicial) regarding the same facts. In the generic drugs cartel case, for example, CADE found the companies guilty of price-fixing, and the alleged injured parties sought redress in court. The judge, however, concluded that there was no antitrust violation and therefore did not award any compensation to the plaintiffs. In any case, one should take the latter as an exception since, on average, judicial courts confirm over seventy percent of CADE's decisions.
24. Pursuant to Article 47 of Brazil's antitrust law, victims of anticompetitive conduct may recover the losses they sustained as a result of a violation, apart from an order to cease the illegal conduct. A general provision in the Brazil Civil Code, Article 927, also establishes that any party who causes losses to third parties must indemnify those that suffer damages. Plaintiffs may seek compensation for pecuniary damages (actual damages and lost earnings) and pain and suffering. Under recent case law, companies are also entitled to pain and suffering, usually derived from reputation losses in the market.
25. *See* Case No. 08012.009888/2003-70 (industrial and hospital gases cartel case), adjudicated by CADE on 1 September 2010. Even before 2010, the local State Prosecution Offices representing alleged victims of cartels spontaneously filed few collective damages lawsuits, most of which—if not all—in connection with regional fuel retail cartel cases that were initially investigated by the same prosecutors. Relevant case law includes two investigations by the State Prosecution Office in Rio Grande do Sul. Defendants in the Guaporé investigation were sentenced to two-and-a-half years of jail time for fixing fuel prices. After the conclusion of the criminal investigation, the State Prosecution Office filed for individual and collective damages and the parties were sentenced to compensate consumers that had been injured by the cartel and to pay collective pain and suffering for "harming society, by having abused local consumers that were affected in their vulnerability." Likewise, in Santa Maria, after retailers were also sentenced to serve jail time, prosecutors filed for individual and collective redress, both granted by the courts.
26. Brazil's legal system allows defendants to have access to all the leniency documents since the very beginning of the investigation, which may interfere with the course of foreign investigations.
27. Case No. 08012.011042/2005-61. Defendant: Shell Brasil Ltda. (currently Raízen Combustíveis S/A). Reporting Commissioner: Marcos Paulo Veríssimo. Adjudicated on 12 November 2014. Earlier in that year, the authority imposed sanctions against pharmaceutical laboratory Merck S/A for having met with the country's largest pharmaceutical companies to prevent distributors from working with generic products. In that case, CADE decided for the admissibility of evidence borrowed from other of its proceedings, in which Merck was not the defendant, reversing the Reporting Commissioner's decision on the issue. Case No. 08012.005928/2013-12. Defendant: Merck S/A. Reporting Commissioner: Marcos Paulo Veríssimo. Adjudicated on 6 August 2014.
28. The so-called investigation is directed to uncover alleged corrupt practices and cartel affecting the state-owned oil company Petrobras. More than thirteen whistleblowers have already signed leniency agreements with the criminal authorities.
29. A grant of leniency under the previous antitrust law extended to criminal liability under the Federal Economic Crimes Law, but not to other possible crimes under other criminal statutes, such as fraud in public procurement. The new antitrust law broadens the leniency grant to increase incentives for leniency.

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Corruption in Commercial Disputes Before the New York Courts and International Arbitration Tribunals

By Julie Bédard

I. Introduction

This article compares the approaches of international arbitration tribunals with those of the courts in New York to three aspects of dealing with questions of corruption in a commercial dispute: applicable law; consequences of corruption; and issues of proof. The article considers situations where a party is trying to resist enforcement of a contract on the grounds that it was formed for a corrupt purpose or that the formation of the contract was somehow tainted by corruption, and therefore the contract is invalid, in addition to cases involving a defense that performance of the contract would require illegal conduct.

II. Corruption and Applicable Law

Several New York courts have judged the legality of conduct by reference to the law of the place of conduct, whereas the consequences of any illegality are determined by the contract's proper law.[1] This is consistent with the approach adopted in the Restatement (Second) on Conflict of Laws § 187(2)(b), which in certain circumstances leads to the application of a law different from the contract's governing law when an interested country's fundamental public policy would otherwise be violated. However, some New York courts have found that this principle does not apply for commercial contracts worth at least $250,000 with an express choice of New York governing law. In those cases, courts have relied on the General Obligations Law § 5-1401, which arguably directs courts to apply only the chosen New York law.[2] Nevertheless, even if a court only applies New York law, it may find that New York law would refuse enforcement of a contract if it was made with a view to violate the laws of other jurisdictions.[3]

In international arbitration, on the other hand, tribunals generally are not bound by a preexisting set of conflict of laws principles and thus may carry out a separate and different analysis to determine what law will govern questions of corruption and its effect on the contract. For example, reported arbitral decisions reflect decisions in which tribunals have declined to hear a claim allegedly tainted by corruption, not through the application of a particular national law, but based on a principle of international public policy against corruption.[4] Many other international tribunals have looked to the conflict of laws rules of the place of arbitration to help determine which law should apply, or considered the laws governing the contract, or mandatory rules (such as corruption laws) of countries connected with the parties or the transaction, or the laws of a country in which any arbitral award is likely to be enforced. Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the "New York Convention," a country may refuse to enforce any arbitral award on public policy grounds if the tribunal did not consider relevant anti-corruption laws. Accordingly, in international arbitration, a tribunal may apply a range of national and international laws beyond the law governing the contract and deny effect to certain contract obligations.

III. Consequences of Corruption

New York courts have refused enforcement of a contract procured by, or involving, corruption, depending upon the strength of the connection between the corrupt act and the obligation sued upon.[5] Some courts have still enforced the contract, however, when the plaintiff was unaware of any illegality or was clearly less culpable than the defendant.[6] Courts have also given plaintiffs some relief under different causes of action, such as restitution, despite refusing to enforce the contract.[7]

Several reported arbitral decisions appear to refuse categorically to grant relief on any claim based on rights obtained or otherwise tainted by corruption. A recent award suggested this was necessary to promote "the rule of law."[8] Nonetheless, at least one tribunal still awarded restitution to a claimant despite invalidating the contract due to corruption.[9] There also has been recent criticism within the arbitration community of the blanket dismissal of any claims tainted by corruption, particularly when the other party, who is also involved in the corruption, may be enriched from a dismissal of the claims. Accordingly, future arbitral tribunals may start to consider the relative culpability of the parties, or the extent of connection between the corruption and the claim, in similar ways to the approach taken by New York courts.

IV. Issues of Proof

Both New York courts and arbitral tribunals have ruled that contracts are presumed legal, and the burden is on the party alleging illegality to prove it.[10] Some New York courts and international arbitration tribunals have decided on issues of illegality, such as corruption, even when not raised by the parties. In either case, courts and the majority of arbitral tribunals often require "clear and convincing" evidence before finding corruption, but the only evidence available may be circumstantial.[11]

Parties before New York courts may have access to greater scope and varieties of discovery, which may assist in proving any corruption. That is arguably balanced against arbitration's generally less strict rules of evidence, while it remains difficult to prove corruption in any forum. This difficulty, and a perceived strong international policy against corruption, has led some tribunals, in special circumstances, to reverse the burden of proof and to require that claimants prove no corruption when a reasonable suspicion of corruption was raised, or to require a lesser standard of proof of corruption.[12] However, based on the reported arbitrations awards dealing with corruption, this does not appear to be the majority approach and a recent leading foreign investment award affirmed the high standard of proof required for finding corruption.[13] Accordingly, the proof of corruption remains a stringent matter in both international arbitration and New York litigation.

Claims of corruption are a sensitive matter, and the New York courts and international tribunals have shown that they are both rigorous and nuanced in their approach to the assessment of such claims.

Endnotes

1. *See, e.g., Korea Life Ins. Co., Ltd. v. Morgan Guar. Trust Co. of New York*, 269 F. Supp. 2d 424, 438 (S.D.N.Y. 2003).
2. *Supply & Building Co. v. Estee Lauder Intern., Inc.*, 2000 WL 22383 at *3 (S.D.N.Y. 25 Feb. 2000).
3. *Lehman Bros. Commercial Corp. v. Minmetals Intern. Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 118, 138 (S.D.N.Y. 2000).
4. *See, e.g.,* ICC Case No. 1110 (1963).
5. *See, e.g., Prote Contracting Co. v. Bd. of Educ. City of N.Y.*, 230 A.D.2d 32, 40-41 (1997).
6. *Republic of Iraq v. ABB AG*, 768 F.3d 145, 162 (2d Cir. 2014).
7. *Am. Buying Ins. Servs., Inc. v. S. Kornreich & Sons, Inc.*, 944 F. Supp. 240, 244-45 (S.D.N.Y. 1996).
8. *Metal-Tech Ltd v. Uzbekistan* (ICSID 2013).
9. *World Duty Free Co. Ltd. v. Kenya* (ICSID 2006).
10. *See, e.g., Dias v. Tire Mart, Inc.*, 27 Misc. 2d 24, 33 (Sup. Ct. 1960); *ECE Projektmanagement Int'l GmbH v. Czech Republic* (UNCITRAL 2013).
11. *See, e.g., Chevron Corp. v. Donziger*, 974 F. Supp. 2d 362, 559 (S.D.N.Y. 2014); *Fraport AG Frankfurt Airport Serv. Worldwide v. Philippines* (ICSID 2014).
12. *See, e.g.,* ICC Cases No. 6497 (1994) and No. 12990 (2005).
13. *See Fraport*, note 11, *supra* (ICSID 2014).

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The Colombian and Mexican Perspective and Experience

By Alejandro Cárdenas

I. Members of the Madrid Protocol in Latin America

There are only two countries in Latin America (not including the Caribbean) which have embraced the Madrid System. Both of these countries did not become a party to the Madrid Agreement, but only joined the Madrid Protocol. The first to join the system was Colombia, in August of 2012, followed by Mexico in February of 2013.

In order to respond to the question as to whether the Madrid System has fulfilled its expectations, it is imperative to distinguish the purpose of the system *per se*, the expectations from the global trademark owners and those of the individual governments of the member parties to the treaty. For the purpose of this article, we will very briefly analyze the motives of Colombia and Mexico had for joining the Madrid Protocol and the results obtained thus far with the implementation thereof.

II. The Experience in Colombia

The Colombian government was motivated to join the Madrid System by two main purposes or goals:

- Assist national companies and individuals in the protection of their trademarks abroad, particularly helping the small and medium-sized enterprises, because of the reduced filing costs, thereby allowing some smaller businesses to become exporters.
- Open the national economy through increased exports and reduction of the deficit in the commercial balance of the country.

From the national perspective, according to academics in Colombia, the system has not measured up to expectations, nor has it fulfilled the goals in the first three years. Colombian companies rarely use the system, since it has not been found to be a practical, useful and inexpensive tool. Thus far, there have been 10,905 international trademark filings by foreign trademark owners designating Colombia. Many of these filings have been multiclass, which would be the equivalent of 21,713 uniclass filings. In contrast, there have only been sixty-six Madrid Protocol filings based on domestic Colombian trademark applications/registration and it is still unknown how many have been resolved.

From the perspective of the international trademark owners coming into Colombia, the system is working well enough. Out of the 10,905 international applications designating Colombia, the local trademark Office has resolved 6,762 of them. According to the trademark practitioners in Colombia, their incoming work from abroad has dropped twenty percent to thirty percent, since the number of provisional refusals that are being issued by the Colombian authorities is small, which adequately serves the purpose of the trademark owners using the Madrid system to go into Colombia.

In connection with the anticipated increment in exports, it appears that that goal has not been achieved. While the total exports by Colombia in 2011, a year prior to joining the Madrid Protocol, amounted to 41,250.3 Million Euros, which represented slightly over 17 percent of the Gross Domestic Product, in 2014 the exports amounted to 41,270.7 Million Euros, which represented 14.52 percent of the GDP. In turn, the imports in those same years had an inverse behavior. In 2011 imports amounted to 39,277.9 Million Euros, equivalent to 16.29 percent of the GDP, while in 2014 imports amounted to 48,196.5 Million Euros, representing 16.96 percent of the GDP. The commercial balance in Colombia shifted from a favorable of 0.82 percent of the GDP to a deficit of -2.44 percent of the GDP.

Year	Exports	Imports	Commercial Balance
2011	41,250.3 M€	39,277.9 M€	1,972.40 M€
2012	46,912.8 M€	46,008.3 M€	904.6 M€
2013	44,290.2 M€	44,723.3 M€	- 433.1 M€
2014	41,270.7 M€	48,196.5 M€	- 6,925.8 M€

III. The Experience in Mexico

The goals expressed by the Mexican Senate for the approval of the Madrid Protocol were primarily focused on the trademark owners belonging to the export sector. Joining the Madrid system was not intended to benefit everyone, but only those selling Mexican goods abroad. The main goal sought was to reduce trademark protection costs to exporting firms, to help them become more competitive. As an indirect benefit, exports could rise. The second purpose was to attract foreign investment into the country, by facilitating the protection of the trademarks.

As in Colombia, there is an important gap between the number of international applications and registration designating Mexico and those whose country of origin is Mexico. Mexico has been designated in 38,816 international applications, making the top ten designated countries within the system (the top two are China and the European Union). In exchange, there have been two hundred twenty-four international applications with Mexico as office of origin. In 2014, there were 8,533 designations of Mexico, and 2,083 of those were from U.S.-originated international applications. The next runner-up was Germany, with 1,813 Germany-originated applications. These numbers show that half of the commercial relations of Mexico are with the United States and Europe.

The first user of the Madrid System in Mexico was Grupo Bimbo, S.A.B de C.V., which in February 2013 filed applications for the marks "BIMBO" and "TAKIS." Grupo BIMBO was one of the biggest supporters of Mexico joining the Madrid Protocol. The larger user of the system is a company called KIDZANIA, S.A.P.I. DE C.V., which has filed ten applications.

As a designated office, IMPI has issued 6,860 provisional refusals. This means that less than 18 percent of the international applications encounter problems when coming into Mexico. Out of those provisional refusals, only 25 percent are issued in connection with formal grounds, mainly having to do with product/service indications. These numbers are a sign that the system is working for the trademark owners who opted for the Madrid System to come into Mexico. Specially, if these numbers are compared to what is happening in the United States, where the amount of provisional refusals issued by the USPTO basically defeats the purpose of the whole system. According to the information published by WIPO in the *Madrid Yearly Review* for 2014, the USPTO issued 17,162 provisional refusals, accounting for 17.5 percent of all the international registrations refused. The figure becomes dramatic when you consider that on that year the United States was designated in 17,268 registrations. Only 106 designations went through.

In connection with the exports, the numbers have been stable in relation to the GDP. In 2012 exports represented 31.32 percent of the GDP, while in 2014 same represented 31 percent However, the deficit in the commercial balance did increase. That is, imports grew more than the exports.

Year	Exports	Imports	Commercial balance
2012	288,626.1 M€	296,137.3 M€	-7,511.2 M€
2013	286,265.0 M€	294,379.5 M€	- 8,114.5 M€
2014	299,236.3 M€	309,809.0 M€	- 10,572.7 M€

IV. Conclusions

To evaluate if the Madrid System has delivered relative to the expectations, it really depends on whose expectations we are looking at. One can argue that the general purpose of the Treaty has been met and the system is very successful. However, if evaluated in light of each member country's expectations and other individual factors, in the case of Colombia and Mexico, the expectative have not been met.

In the case of Colombia, the government motives and expectations were unrealistic as to the realities of Colombian nationals. A large part of the foreign commerce of Colombia is with the Andean countries, Bolivia, Chile, Ecuador and Peru, as well as with Brazil and Argentina. Colombia entered the Madrid System because of U.S. pressure under the provisions of the Colombia Trade Promotion Agreement. Since the United States is refusing more than 95 percent of the international applications, Colombia is not getting that benefit in the increased trade with the United States. Colombia would have had greater benefit for its nationals if it had pushed instead to take the Andean Pact a step further and create a truly regional trademark registration, similar to the CTM. Once that were done, as a bloc they could enter into the Madrid Protocol.

In the case of Mexico, the Madrid System works well. IMPI has not had to hire more people to make the system work and meet the deadlines. The number of provisional refusals is adequate for the users of the system to benefit from it. The expectation, however, has not been met, but not because of the system *per se*, but rather in the context of the main business partners of Mexico, which are the United States and the E.U. The route to the U.S. Registry via the Madrid Protocol is inefficient, because of the local U.S. laws and regulations, causing the USPTO to refuse almost every application. That defeats the goal of inexpensive registrations. On the other hand, the E.U. has the CTM system, which has advantages over using the Madrid System.

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Thoughts from the European Union Perspective

By Pierodavide Leardi

I. The Madrid System and the European Union

The European Union is a unique partnership among twenty-eight countries that is currently governed—after the entry into force of the Treaty of Lisbon in 2007—by two main treaties: the Treaty on the European Union and the 2012 Treaty on the Functioning of the European Union. The E.U. treaties are binding agreements among the Member States. They set out objectives, institutions and relationships between the Member States, and establish how decisions are made by the E.U. and or its institutions, bodies and agencies.

The European Union is now a single entity that, as such, can be a contracting party to different international agreements. As a consequence, the European Union is a contracting party to several international agreements that affect the E.U. protection of trademarks. Of these, the most significant are the following:

- The Paris Convention for the Protection of Industrial Property (1883).
- The Nice Agreement concerning the International Classification of Goods and Services (1957).
- The TRIPs Agreement (1994).
- The Madrid Protocol concerning the International Registration of Marks (1989).

The same agreements have also been ratified by almost all E.U. Member States.[1]

The reasons why the E.U. and all its Member States welcomed, and easily became parties to, these treaties can easily be summed up: (i) international trade and international cooperation needs were the drivers of the whole process; (ii) trademark law provisions set out by the Paris Convention and by the TRIPs Agreement were also consistent with the laws of each Member State and of the E.U.; and (iii) most Member States were already parties to the Madrid Agreement, seeking international cooperation and exchange in the field of trade.[2]

The European Union thus became a party to the Madrid Protocol on 1 October 2004. As a result of its accession to the Madrid System, it is now possible for a trademark holder to either:

– file an international application based on a CTM; or

– designate the European Union in an international trademark application.

It is worth underlining that the designation of the European Union in an international trademark application, or subsequent designation, means that the applicant is seeking a Community trademark, or "CTM," registration and not national trademark registrations in the countries that are part of the European Union. Thus, it is possible to jointly choose to designate the E.U. and each or any Member State of the E.U. in an international trademark application or subsequent designation. The result will be a CTM registration and one or more national trademark registration.

The Madrid system and the CTM system now work closely together. A few figures will show actual relationships between the two systems.

The first chart shows the number of CTM applications filed either directly or through the Madrid System. It clearly shows that, in recent years, the number of direct CTM applications has constantly been increasing while the number of CTM applications filed by means of an international application has fallen significantly.[3]

	2012	2013	2014
Direct CTM applications	91,949	96,078	100,281
International CTM applications	16,029	18,201	17,183

The following chart shows that the number of international trademark applications filed on the basis of a CTM application or registration through the OHIM via the Madrid System. The number of applications has been increasing steadily.

	2010	2011	2012	2013
International trademark applications filed by the OHIM via the Madrid System	14,636	16,354	16,906	17,630

II. The European Union Trademark ("CTM")

The European Union Trademark, or CTM (formerly Community Trade Mark), is a single trademark which is valid in all the countries of the European Union. It covers

Austria, Benelux, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom. Notably, Norway, Iceland, Finland, Monaco and Switzerland are not part of the CTM system.

It is important to point out that a CTM does not consist of a bundle of national trademark registrations and it cannot be applied for and/or registered in only some of the E.U. Member States.

The CTM has its own regulation—which is EC Regulation no. 207/2009—on the Community trademark, and it is managed by the OHIM, the Office for Harmonization in the Internal Market, the European Union agency responsible for managing the CTM and the registered Community Design (RCD). The office is based in Alicante, Spain.

The CTM does not serve as a substitute for national trademark registrations, which are still governed by the laws of each E.U. Member State. There are some differences between national trademark laws and the CTM regulation. However, the protection of trademarks in Europe is based on a common legal framework. The trademark laws of each E.U. Member State were approximated by EC Directive 95/2008 (formerly Directive 104/89), which harmonized the main principles of trademark law between all the Member States, and the same principles of the directive also govern the CTM Regulation. The European Court of Justice has exclusive jurisdiction for the interpretation of the Directive, thus ensuring its uniform interpretation and application throughout the European Union.

According to the CTM Regulation, a Community Trademark:

- shall have a unitary character;
- shall have equal effect throughout the Community;
- shall not be registered, transferred or surrendered or be the subject of a decision revoking the rights of the proprietor or declaring it invalid, nor shall its use be prohibited, save in respect of the whole Community;
- may be transferred, separately from any transfer of the undertaking, in respect of some or all of the goods or services for which it is registered;
- may be licensed for some or all of the goods or services for which it is registered and for the whole or part of the Community.

It is also worth mentioning that a community trademark may consist of any signs capable of being represented graphically, particularly words, including personal names, designs, letters, numerals, the shape of goods or of their packaging, provided that such signs are capable of distinguishing the goods or services of one undertaking from those of other undertakings.

A CTM confers a right on the proprietor to prevent others from:

- using in the course of trade any identical or similar sign for identical or similar goods when there exists a likelihood of confusion or association between signs (risk of confusion theory); and
- also using in the course of trade any sign which is identical with, or similar to, the Community trademark in relation to goods or services which are also not similar to those for which the Community trademark is registered, where the latter has a reputation in the Community and where use of that sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the Community trademark (anti-dilution theory: a blurring and tarnishment of famous trademarks).

The registration process of a CTM provides for a preliminary formal examination, publication of the application, and an opposition period of three months after publication of the application. At the end of the opposition period, if no opposition or third party observation has been filed, the application is granted and published.

The CTM Regulation also sets forth different provisions concerning legal actions to protect community trademark rights.

First, each Member State has a limited number of designated national courts—referred to as Community trademark courts—with exclusive jurisdiction over CTM infringement and validity cases. These courts have exclusive jurisdiction:

- for all infringement actions and, if they are permitted under national law, actions in respect of threatened infringement relating to Community trademarks;
- for actions for declaration of non-infringement, if they are permitted under national law;
- for counterclaims for revocation or for a declaration of invalidity of the Community trademark.

As mentioned before, in these cases the applicable law is EC Regulation 207/09 and not national trademark laws.

For matters involving the issuance of provisional and protective measures, the CTM Regulation provides that Community trademark courts may award injunctions and other protective measures in respect of a CTM registration and/or CTM application to the extent that they are avail-

able for national trademarks under the law of the Member State of the Community trademark court deciding the case at issue. For example, this is permitted in Italy according to the Italian IP Code. Also, in some circumstances, pursuant to Article 103.2 of the CTM Regulation, the provisional and protective measures issued by a Community trademark court are applicable in the territory of any other Member State.

On the other hand, pursuant to Article 56 of the CTM Regulation, the OHIM has exclusive jurisdiction for direct claims for revocation and a declaration of invalidity.

III. Protecting a Trademark in the European Union Through the Madrid System

Now that the European Union is a contracting party to the Madrid Protocol, a CTM application can be applied for by means of an international trademark application or subsequent designation. According to Article 151.1 of the CTM Regulation, an international registration designating the European Union shall, from the date of its registration pursuant to Article 3(4) of the Madrid Protocol, or from the date of the subsequent designation of the European Community pursuant to Article 3ter of the Madrid Protocol, have the same effect as an application for a Community trademark. Consequently, according to Article 151.2 of the CTM Regulation, the international registration of a mark designating the E.U. shall have the same effect as the registration of a mark as a Community trademark.

There are, nonetheless, a few differences between the date of publication of a direct CTM application and the date of publication of an application and registration of a CTM filed via the Madrid System. The key provisions are Articles 9.3 and 151.3 of the CTM Regulation. Article 9.3 states that,

> The rights conferred by a Community trade mark shall prevail against third parties from the date of publication of registration of the trade mark. Reasonable compensation may, however, be claimed in respect of acts occurring after the date of publication of a Community trade mark application, which acts would, after publication of the registration of the trade mark, be prohibited by virtue of that publication. The court seized of the case may not decide upon the merits of the case until the registration has been published.

Article 151.3, concerning CTM application filed through the Madrid system, states that "on the purposes of applying Article 9(3), publication of the particulars of the international registration designating the European Community pursuant to Article 152(1) shall take the place of publication of a Community trade mark application, and publication pursuant to Article 152(2) shall take the place of publication of the registration of a Community trade mark."

It must also be said that, for a directly filed CTM, pursuant to Article 15 of the OHM Regulations, the required five years of genuine use term starts from the date of registration (Art. 15 CTM Reg.). For a CTM filed through the Madrid System, pursuant to Articles 152.1 and 160 of the CTM Regulations, the same term starts from the date of publication by the OHIM of the date of registration of an international mark designating the E.U.

The registration process for a CTM applied for through the Madrid System closely mirrors that of a direct application, and it includes formal and substantive examination and the possibility of opposition procedures and third party observations. Concerning the costs of a CTM application filed through the Madrid System, the OHIM chose to require exactly the same official registration fee of 900 Euros for the first three classes of products and services and 150 Euros for each additional class.

In light of the above, it is clear that a CTM application filed through the Madrid System is a valid substitute for a directly filed CTM application. That having been stated, what really makes the difference between direct CTM applications and CTM applications filed through the Madrid System is everyday practice and how the system actually works.

The first big difference is the actual speed for the examination process of direct applications. Now that the OHIM has fully implemented the so-called "Fast Track" examination procedure, a direct application can often be examined and published in a matter of days (seven to ten days after the date of application), thus being granted three months and a few days later.

The main requirements for using the Fast Track procedure are:

- The applicant must have a domicile in the E.U.;
- The mark must be either a word mark, a figurative mark, a 3D mark or sound mark;
- There must be no description or disclaimer in the application;
- Priority documents must be attached to the application;[4]
- The list of goods and services must be selected from the OHIM database of accepted terms;
- There is immediate payment of the registration fees.

The Fast Track procedure is even easier to use, since no Power of Attorney is needed to allow a legal representative to file a CTM application. A Power of Attorney

must be filed only when the OHIM or any other party involved in proceedings expressly requests it.

Moreover, the entire CTM management system is clearly designed to allow quick and easy communication between the holder or its representative and the office. This means that renewal, total or partial transfer, priority and or seniority claim, right in rem, alteration of the mark, license, division, total or partial surrender, and any other recordal can be filed quickly, at almost no cost and with few formalities.

IV. Conclusions

Entry of the European Union into the Madrid System has provided companies, entrepreneurs and IP professionals with a very useful tool.

From a legal point of view the Madrid System is fulfilling its promise, since a CTM registration filed through the Madrid System offers the same protection as that granted by a directly filed CTM application, while the applicant still enjoys the benefits of a unitary application procedure.

The Madrid System works even better for international trademark applications based on CTM applications. Indeed, an international trademark application can be filed very easily through the OHIM using a CTM application as the "basic application." It is a very quick and cost-effective practice to protect European trademarks outside the E.U. that—as it is shown in the second chart in the first part—is becoming widely used by experienced E.U. trademark counsel.

On the other hand, common practice has shown that filing a direct CTM application—through an E.U. representative—can be a very good option also for trademark holders based outside the European Union The main advantages will mainly be the speed of the actual examination and grant of the application, long term benefits in terms of renewals and recordals, quicker communication between the OHIM, the E.U. representative and the holder or the holder's representative; and immediate advice by an E.U. trademark counsel. Indeed, when seeking trademark protection for such a huge market as the E.U., it might be advisable to appoint a local trademark lawyer.

Endnotes

1. Cyprus and Malta are not contracting parties to the Nice Agreement and the latter is not party to the Madrid Protocol.
2. Only the following E.U. Member States are not party to the Madrid Agreement: Estonia; Finland; Greece; Ireland; Lithuania; Sweden; and the United Kingdom.
3. CTM's top ten applicant countries in 2014 were, in order: Germany; USA; U.K.; Italy; Spain; France; Switzerland; Netherlands; Poland; and Austria.
4. According to OHIM general practice, where the applicant in its application claims the priority of a first filing the applicant must, in principle, within three months from the filing date submit a copy of the relevant first application. If the first filing took place in a non-E.U. language, a translation has to be sent (this translation does not have to be certified). The applicant is not required to file a copy of the first filing if the required information is available to the office on the website of the respective national office. If the copy of the prior application is not submitted, the examiner will thus first seek it on the respective website himself and only if the information is not available, the applicant will ask for it. The copy of the relevant application must consist of a copy (simple photocopy is sufficient) of the documents certified by the national office or an extract or printout from an official database, provided this contains all necessary data (country, application number, applicant's details, trademark, full list of goods and services).

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Looking for Past Issues of the *International Law Practicum*?

http://www.nysba.org/IntlPracticum

Will Brazil Join the Madrid System?

By Marcos Chucralla Moherdaui Blasi

I. Introduction

The purpose of this brief paper is to access the reasons behind the Brazilian resistance to adopting the so-called Madrid System for trademark registration, as well as attempting to identify the trend for the near future. Basically, it intends to examine the back and forth on this issue during the last twenty-six years, in light of the main aspects raised by its supporters and opponents.

While Brazil is inserted in Latin America's context, some references will be made to the region as a whole in order to identify some points of contact and opposition.

II. Overview of the Madrid System

Administered by the World Intellectual Property Organization (WIPO), a U.N. specialized agency, the "Madrid System" is an international system for facilitating the registration of trademarks in multiple jurisdictions around the world.

Its legal framework is provided by a multilateral treaty, namely, the Madrid Agreement Concerning the International Registration of Marks of 1891, as well as by the Protocol Relating to the Madrid Agreement 1989.

The benefits of the system are summarized by WIPO as the following: (i) *convenience*—centralized filing and management procedure; (ii) *cost effectiveness*—one application replaces the need of filing a bundle of national applications; and (iii) *broad geographic coverage*—ninety-five countries that represent in excess of eighty percent of world trade.[1]

The mechanics of the system are relatively simple:[2] before one can file an international application, one needs to have already registered, or have filed an application, in one's "home" IP office, to which one will submit one's international application.

The application is then submitted to WIPO, which will conduct a formal examination. Once approved, the mark is recorded in the International Register and published in the *WIPO Gazette of International Marks*. WIPO will then send the applicant a certificate of international registration, valid for a ten-year period (renewable successively), and notify the IP Offices in all the political jurisdictions where one wishes to have the mark protected.

The IP Offices of the political jurisdictions where one wants to protect the mark will define the scope of protection and issue a decision within the applicable time limit (twelve or eighteen months) in accordance with their legislation. WIPO will record the decisions of the IP Offices in the *International Register* and then notify the applicant.

A decision of denial in one country will not affect the decisions of other IP Offices. One can contest a refusal decision directly before the IP Office concerned in accordance with its legislation. If an IP Office accepts to protect the mark, it will issue a statement of grant of protection.

At first glance, considering that WIPO is composed of one hundred eighty-eight countries, it can be easily seen that, despite WIPO's and other association's efforts, the Madrid System cannot be considered exactly a uniform system. Let's try to understand why in the Latin America context.

III. Latin America and Madrid System: The 1996 ASIPI Resolution

Seven years after the Protocol of 1989—more precisely on 23 October 1996—the board of the Intellectual Property Interamerican Association (*Asociación Interamericana de la Propiedad Intelectual*—ASIPI) issued a resolution in which it reported the results of its internal studies regarding the Madrid System ("Resolution"). The recommendations for its members were basically the following:

- To study, deeply and jointly with the private and public actors, the implications of the Protocol application in Latin American countries.
- To invite the national authorities to reflect exhaustively about the consequences of the ratification of the Protocol before taking any decision about it.
- To take into consideration that they have total freedom to decide about this matter independently and at their convenience.
- If it is the case, to request improvements in the local legislation in order to allow a free decision about this subject and prevent third parties from forcing a quick and not well reflected position about it.
- To cooperate to spread the Resolution to all interested parties.

The tone of the Resolution makes clear that, at least from a Latin American standpoint, the adoption of the Madrid System was seen with reservations (especially

regarding some legal issues that will be discussed below) and was not considered a trivial decision to be taken by the countries.

The Resolution can be considered the most influential guideline regarding the Madrid System in Latin America and, for many years, dictated the trend of the countries of the region regarding this matter. As a result, many relevant countries, like Chile, Argentina and Brazil, have up to now not acted to adopt the system, and only recently, in 2012, Colombia and Mexico became the first significant movers to do so. The Brazilian situation will be discussed in more detail below.

IV. Brazil: The Long Road of Discussions

During the last twenty-six years, Brazil's accession to the Madrid System has been announced more than once by the government, but, up to this moment, has not become a reality.

Due to this fact, an application for trademark registration in Brazil can only be filed at the national level, *i.e.*, directly with the Brazilian Industrial Property office (INPI). If the applicant has its domicile outside the country, the applicant will need to appoint a representative domiciled in Brazil as its authorized receiving agent.

For the ease of exposition, we can divide the referred period into three major developments, as follows.

A. 1989-1996: Absence of Deep Discussions

From the issuance of the Madrid Protocol until 1996, the discussions about the adhesion to the Madrid system were relatively rare in Brazil. The country was in a moment of consolidation of its democracy after two decades of military regime, 1964 to 1985, and was still building its new legal framework: the Federal Constitution was enacted in 1988.

During this period, the nation's strategic goals were being defined, and the international agenda was mainly oriented to the regional integration (the Mercosul would be erected in 1995 by Brazil, Argentina, Paraguay and Uruguay), and there was an opening of the economy to foreign markets in 1990, after years of protectionism sponsored by the government.

The panorama starts to change with the evolution of the multilateral negotiations that resulted in the creation of the World Trade Organization (WTO) and its basic agreements, including the TRIPS, in 1995. The government recently managed to accelerate the procedures for the immediate incorporation of such treaty and the addition of the new Industrial Property Law.[3]

B. 1996-2001/2002: Preliminary Studies, ABPI Contrary Position and Supporters' Arguments

Under the influence of the 1996 ASIPI Resolution (mentioned in Part III), the Brazilian Intellectual Property Association (ABPI) started some studies and discussions about the Madrid Protocol. The position of the entity was reflected in the Resolution 23, approved by the Executive Committee and the Board of Directors on 5 April 2002.[4]

Based also on the legal opinion issued by the former Supreme Court Justice, Minister of Justice and Professor Célio Borja,[5] the resolution pointed out some constitutional, legal and practical obstacles to the incorporation of the system. Basically, it was argued that the Protocol was incompatible with the Brazilian legal system, since it violated the equality principle between nationals and foreigners, the concept of Portuguese as the official language of Brazil, and the concept of the automatic grant if the application was not analyzed within the eighteen-month term, among other arguments.

On the other side, during the same year, industry representatives like FIESP (Industrial Federation of the State of São Paulo) and FIRJAN (Industrial Federation of the State of Rio de Janeiro) manifested their support of accession to the Protocol, seen as a way of reducing the costs and the bureaucracy for obtaining trademarks abroad. The accession of the United States and of the European Union, strategic partners of Brazil, to the Madrid System was also emphasized as a way of supporting the urgency for taking a position.[6] José Graça Aranha, the Brazilian long-term Director of WIPO and a strong supporter of the Madrid System, issued a legal opinion[7] opposing each of the obstacles raised by the other side.

Practical aspects were also not forgotten during the discussions. For instance, the main perceived disadvantage of the Madrid System was that the international application or registration is dependent on the basic application or registration. Therefore, any refusal, withdrawal or cancelation of the basic application or basic registration within five years after the registration date of the international registration will lead to the same effect for the international registration. However, the international practice has shown that the number of international registrations cancellations is minimal.

As another example, there is not a twelve- to eighteen-month term for the PTO to examine the application, after which the trademark is automatically granted, therefore causing an inequality between the treatment attributed to nationals and foreigners. In such a situation, the PTO must inform WIPO that there is a problem with the referred trademark and set a new term for its analysis.

The same happens with the seven-month term for examination of oppositions. Such a term may be used by those countries that perform a deeper examination of the application and wish to report to WIPO in this respect. During the national phase, the trademark can be republished for the acknowledgement of third parties.

C. 2001/2002 to the Present: INPI and the Government Make a Movement—a New Round of Discussions

The winds started to change direction when—after a long period without having a clear position from the government about whether to join the Madrid System—the INPI started to advocate that Brazil should adhere to it, with the support of the Ministry of Development, Industry and Foreign Commerce (MDIC).

The INPI and the government started to participate in the discussions: many debates and workshops were conducted, the main points were deeply discussed, lessons were learned from other countries' experience and in the course of accession (*e.g.*, the United Kingdom took seven years to implement it). After all this, a certain level of consensus was achieved.

The pendulum swung from arguing the total incompatibility of the Madrid System with the Brazilian system to managing to integrate the Madrid treaty concepts within the local framework in order to provide an additional and facultative mechanism of registering trademarks.

After approximately ten years of discussions, however, it seems that, although most of the legal obstacles were overcome, there is still an ambivalent feeling about the Madrid System: while industry envisages competitive advantages and reduction of costs and bureaucracy, there is also a threat of not having the material conditions to duly incorporate the System, due to INPI's lack of capacity to meet effectively the Protocol requirements, which could potentially harm Brazilian users.

Finally, on 9 April 2013, in its consideration of accession to the Madrid Protocol, CAMEX (the Federal Government's Chamber of Foreign Trade) approved Brazil's adhesion to the Protocol. A press release issued by INPI indicated that the Executive Branch (Casa Civil) was to introduce Madrid Protocol legislation for consideration by the Brazilian Congress.

Following this step, the INPI started to structure itself to meet the Protocol requirements, for instance, by allowing the possibility of requesting the trademark in more than one class simultaneously and the possibility of including more than one owner for the same trademark. But both reforms have not been implemented yet.

V. Conclusion: The State of Art and Trends

The discussion regarding Brazilian participation on the Madrid System didn't evolve after the INPI's last version and there is no signal that it will happen soon.

Currently, Brazil is dealing with a complex political and economic crisis and cutting some expenses. On its part, INPI—which is not an independent agency—is facing both a huge backlog and motivational (*e.g.*, the loss of examiners to the market) challenges, and has not yet demonstrated a real capacity to take the needed steps to incorporate the Madrid System.

There is also speculation on how the new INPI's president, nominated in the end of July 2015, will deal with this matter.

In case the government or INPI restarts the discussion about acceding to the Madrid System, Brazil will surely put into the balance what is the local perception about it and how the system is working in other countries such as the United States, the European Union, Canada, Colombia and Mexico.

Endnotes

1. http://www.wipo.int/madrid/en/madrid_benefits.html.
2. http://www.wipo.int/madrid/en/how_madrid_works.html.
3. The resolution is available at www.abpi.org.br.
4. Published as an attachment of the ABPI Review n. 59 (July/August 2002).
5. It must be noted that the number of members increased substantially during the period: from a few more than twenty in 1996 to sixty-six in 2005.
6. Published as a book: J.G. Aranha, Tratado de Madrid (Rio de Janeiro: Lumen Juris 2004).
7. The changed character of the debates can be seen, for instance, in a meeting that took place at ASPI (São Paulo INP Association) reported in the ABPI Bulletin No. 106, at 5 (July 2009).

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Commentary: Cross-Border Insolvency in Brazil: The Need for Rules

By Thomas Benes Felsberg

I. Introduction

Brazil is consistently ranked by the IMF and by the World Bank as one of the world's ten largest economies. As such, an impressive number of multinational companies are headquartered or have assets in the country. In addition, Brazilian companies are investing heavily abroad. The economic and financial problems of all such companies generate an array of cross-border issues that require a systematic approach for either their eventual reorganization or liquidation.

These approaches may be universal or territorial in nature. Under the universality principle, the court where the center of main interests of the debtor is located would have worldwide jurisdiction over its assets and would coordinate an insolvency proceeding: creditors of each class would be treated equally and the interests of all stakeholders would probably be better preserved. On the other hand, a territorial approach would imply a plurality of insolvency proceedings, as various countries would have jurisdiction over the assets within their own borders. Although the territorial principle appears to better protect local creditors, the reality is that in the last decades insolvency laws around the world have been moving toward the universality principle, which requires, in order to be effective, cooperation and coordination among courts in different countries.

UNCITRAL adopted a Model Law on Cross-Border Insolvency in 1997, which was enacted by several countries such as the United States, the United Kingdom and Japan. The European Union enacted its Council Regulation (EC) 1346/2000 to regulate cross-border insolvency, and different countries have adopted different approaches to deal with the matter. Others, such as Brazil, have largely ignored this trend, as explained below.

II. Brazilian Cross-Border Insolvency Legislation

In 2005, the Brazilian corporate insolvency law underwent a major reform, which resulted in the enactment of Law 11,101/2005. The new law created a court-supervised reorganization proceeding similar to Chapter 11 of the U.S. Bankruptcy Law and introduced changes to streamline the liquidation proceeding. However, just like the preceding corporate insolvency law (Decree-Law 7,661/1945), Law 11,101/2005 failed to hand down rules regulating cross-border issues.

The Bustamante Code of 1928, as part of the Inter-American Convention of Private International Law, was signed by fifteen Latin American countries, and was ratified by Brazil and is still in force. The Bustamante Code contains several provisions relating to cross-border insolvencies. However, although the Code has been used in a few cases, even some involving non-signatory countries, courts tend to ignore it in most instances.

The Code of Civil Procedure of 1939, which was revoked by the 1973 Code, also contains rules related to the international aspects of insolvency. However, the 1973 Code does not contain rules regarding cross-border insolvencies. The new Code of Civil Procedure will come into effect only in March of 2016, but it also does not regulate international insolvencies. Thus, the only legal provisions in respect to international insolvency which exist in Brazil are either (i) only applicable to fifteen Latin American states and are thoroughly outdated (though there is a Supreme Court decision from 1942 which applied the rules of the Bustamante Code to a case conflicted with a non-signatory country) or (ii) have been revoked. When necessary and/or convenient, lawyers and the courts have used these rules for lack of a better alternative.

Decree-Law 4,657/1942, the Introductory Law to the Civil Code, governs conflict of laws in Brazil. It has no specific provisions on cross-border insolvencies, but it does contain rules on contracts, corporations and related aspects, which in some instances can be helpful.

It must be emphasized that there is no relevant or consistent case law on the subject, and the applicability of the pieces of legislation mentioned above to regulate cross-border insolvency matters is uneven. Many issues are still open to interpretation and a territorial reading of the provisions of Law 11,101/2005 cannot be dismissed.

III. Jurisdiction of Brazilian Insolvency Courts

Law 11,101/2005, similarly to the former bankruptcy law, provides that the courts where the principal place of business of a debtor is located have (exclusive) jurisdiction over insolvency proceedings. The same applies to branches of foreign businesses which operate in Brazil. For the purposes of the law, subsidiaries of foreign companies receive the same treatment as Brazilian-controlled companies. Therefore, instead of center of main interests (COMI), Brazilian law adopts the concept of principal place of business, which is, in fact, in many respects, similar to COMI.

Although the law is silent on this respect, an insolvency proceeding opened in Brazil governs all the assets of the debtor, regardless of their location. Brazilian insolvencies have, therefore, extra-territorial effects.

There are, however, no rules regarding international cooperation and coordination between or among courts in more than one country. Law 11,101/2005 simply ignores the possibility of parallel proceedings with respect to the same debtor in different jurisdictions, and it does not recognize the existence of a foreign main or ancillary proceedings.

IV. Recognition of Foreign Judgments

Law 11,101/2005 has no provisions for the recognition of court decisions issued in foreign insolvency proceedings. In the absence of specific rules, the general rules set forth by the Constitution, by the Introductory Law to the Civil Code, and by the Code of Civil Procedure, which require an *exequatur* for the recognition of foreign judgments, are applicable. Thus, despite the absence of detailed rules, recognition and enforcement of an award by a foreign insolvency proceeding is in theory possible in Brazil, provided the conditions discussed in the next paragraph are present.

A foreign judgment must be submitted to the Superior Court of Justice (the second highest federal court in the Brazilian judiciary system) for the issuance of an *exequatur*, in order to become enforceable in Brazil. After the issuance of *exequatur*, the claimant may enforce the foreign judgment in a lower court of competent jurisdiction. In order to be recognized in the country, a foreign court decision must be final and not subject to any appeal, and must not violate Brazilian sovereignty, public policy or morality, all of which are rather generic concepts. Thus, in most instances it is better to recognize a trustee or an administrator of a bankrupt estate by the applicable Brazilian conflicts rules on corporate representation than to try to recognize the award. On the other hand, in order to mitigate the risks and delays associated with a recognition of a foreign award proceeding, in many cases it is possible to obtain a temporary restraining order, or injunctive relief, while the proceeding before the Superior Court of Justice is pending.

Brazil will not recognize a foreign judgment in cases where the law provides for exclusive Brazilian jurisdiction. As such, a foreign court decision regarding the insolvency of a debtor with its principal place of business located in Brazil will not be granted *exequatur*. In addition, Brazilian courts have exclusive jurisdiction over rights *in rem*. As a result, disputes over real estate property of the debtor, even if utilized to secure claims against it, may not be subject to a foreign insolvency proceeding in many respects.

As a practical matter, the recognition of foreign insolvency decisions have been rejected by the Brazilian Superior Court of Justice. A possible alternative is to file directly in Brazil a parallel insolvency proceeding instead of recognizing a foreign proceeding.

V. Treatment of Foreign Creditors and Claims

Brazilian law provides for the equal treatment, from a formal point of view, of both local and foreign creditors. Foreign creditors must be represented by local attorneys and all documents must be officially translated into Portuguese to be considered valid in court, and there are no rules aimed at assisting or providing information to foreign courts.

Except if released from such an obligation by a treaty regarding cooperation and assistance of jurisdictional matters, a creditor domiciled abroad is only entitled to file for involuntary insolvency against a debtor if it posts a bond to secure court costs and the award.

There are also some rules regarding claims in foreign currency (applicable even if the creditor is not domiciled abroad). In a liquidation proceeding, all claims in foreign currency must be converted to Brazilian currency as of the date the liquidation proceeding is opened. A reorganization plan, however, may not convert a claim in foreign currency into local currency without the consent of the creditor holding such claim.

VI. Reorganization Cases involving Foreign Companies

It is clear that the Law 11,101/2005 is not prepared to address adequately issues relating to international insolvency. The lack of clear rules on the subject hinders not only the recognition of judgments in foreign insolvency, but also fails to establish benchmarks regarding a current fact brought before Brazilian courts—the filing in Brazil of judicial reorganization proceedings involving foreign-based companies.

Some of the largest recent cases—such as OGX, Aralco, OAS, Lupatech, and Schahin—involved the joint filing of companies incorporated in Brazil and companies incorporated in foreign jurisdictions. Indeed, among the groups of companies incorporated in Brazil that filed for reorganization and that did not include in its core foreign companies are Inepar, Arantes, Agrenco, Infinity Bio-Energy, BUSSCAR, Frialto, Galvão Engenharia, Hermes coral Network energy, Dallas Rent-a-Car, OSX, Daslu, LBR, Camera and Laselva.

In the OGX case, from the four companies that filed for reorganization, two were based in Austria. The lower court judge accepted the filing for the Brazilian companies, but denied the inclusion of the foreign companies, on the ground that Brazil adopts the territorial principle. The decision was later reversed by the Court of Appeal of Rio de Janeiro, which adopted a universalist perspective—in which the country in which the debtor has its principal establishment (the Brazilian concept for COMI, *i.e.*, Center of Main Interests) had jurisdiction to hear the insolvency.

Two recent cases presented interesting developments. In March of 2015, OAS filed for the joint reorganization of ten companies, claiming to be part of the same corporate group, among which three were located abroad. In April 2015, the filing of Schahin involved twenty-eight companies, fifteen of which were incorporated in foreign countries. The joint filing was accepted in both cases, although several of the foreign companies were subsequently excluded from the insolvency proceeding. In the OAS reorganization proceeding, two of the three foreign-incorporated entities—OAS Finance Ltd. and OAS Investments Ltd.—requested their exclusion from the proceeding. The plea was denied by the Bankruptcy Court of São Paulo on grounds that the proceeding had already commenced and that the exclusion of any of them could only be done with the approval of the creditors. There is a pending appeal about this matter filed before the Court of Appeals of São Paulo.

In the Schahin case, an international creditor claimed that, due to contractual provisions in their loan agreements, the management of six of the foreign incorporated companies had been changed and therefore requested the exclusion of the companies from the proceeding, which in this case was granted by the judge. Moreover, the judge concluded that eight of the other foreign incorporated companies did not conduct activities in Brazil. Thus, the judge granted the commencement of the judicial reorganization only to one of the foreign companies controlled by Schahin. There is also an appeal pending against this decision. The new controversies brought by all these new filings require a modification of the Brazilian bankruptcy law.

VII. Conclusion

Law 11,101/2005 revamped Brazilian insolvency system, but failed to address cross-border matters. While it allows for the recognition of foreign insolvencies, the existing legal framework is fragile and not in line with the current international standards and guidelines.

Therefore, as a result of the lack of clear rules and of relevant case law on recognition of foreign proceedings and on cooperation and assistance among courts, Brazilian law does not provide the necessary certainty in this area. Nevertheless, the country could take a big step in promoting international commerce and finance by enacting supplementary legislation to incorporate provisions encouraging the adoption of universality in cross-border insolvency matters.

The Brazilian chapter of Turnaround Management Association (TMA) is promoting the development of studies and discussions on a new reform of insolvency law in Brazil, and one of the issues covered is the enactment of cross-border provisions. The UNCITRAL Model Law on Cross-Border Insolvency could serve as a guide for this reform, helped by the World Bank Principles on Effective Insolvency and Creditor Rights Systems, the UNCITRAL Legislative Guide on Insolvency Law and by initiatives put forward by INSOL, the American Bankruptcy Institute, the International Insolvency Institute and other important international organizations.

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Law Report: The Sinking of Safe Harbor—and Navigating the Stormy Waters Ahead

I. Introduction

As 2015 came to a close, we all witnessed the sinking of the Safe Harbor regime. This framework was set up to protect transfers of personal data from Europe to companies based in the United States of America.

European data protection legislation prohibits the transfer of data outside Europe, except in certain circumstances. One such circumstance is that the country that the data are being transferred to has been approved by the European Commission as providing adequate protection for personal data. Unfortunately, for various reasons, the United States has not been approved as providing such protection. However, in 2000 a political agreement was reached that allowed companies which committed to certain privacy standards to be exempted from this prohibition.

This Safe Harbor Agreement was in place for a number of years. However, in the wake of the Snowden U.S. surveillance revelations in 2013, Austrian citizen Maximillian Schrems brought a legal challenge to Safe Harbor before an Irish court. Schrems's data was being transferred from Facebook's Irish subsidiary to the United States. He wanted the Irish data protection regulator to investigate his claim that the United States does not offer protection against surveillance by United States intelligence authorities of data transferred to the United States from the European Union.

In the first instance, the data protection authority held that as the transfer was made under Safe Harbor, a decision reached by the European Commission, it was unable to call that decision into question. The High Court had to decide whether this determination was correct. Since the issue involved an interpretation of E.U. data protection law, the Irish court had to refer to the European Court the question of whether the 2000 Safe Harbor Decision prevents a national data protection regulator from investigating a complaint claiming that a country doesn't ensure an adequate level of data protection and, where appropriate, suspend the contested personal data transfer.

The European Court ruled that:

- National E.U. Member State data protection regulators do have the independent power to investigate complaints about the adequacy of the level of protection of data transfers to the United States and to suspend data transfers if they conclude that the United States (or indeed any other jurisdiction outside the European Economic Area ("EEA") does not provide an adequate level of protection; but also that
- The E.U. Safe Harbor regime is invalid.

II. Outcomes and Comments

Although long term the first part of this decision may well turn out to be incredibly significant, it's the second part that has had the greatest impact on business.

We are still waiting for the Irish data protection regulator to examine Schrems's complaint and decide whether, under E.U. Data Protection Directive 95/46, the transfer of the data of Facebook's European subscribers to the United States, should be suspended on the ground that the United States does not afford an adequate level of protection of personal data. The Irish regulator has announced that it will be addressing this matter as quickly as possible, and the outcome will be of major importance.

However, in the meantime, the Safe Harbor regime no longer acts as a blanket exemption to the prohibition on transferring data outside the EEA or jurisdictions adduced by the Commission to provide adequate protection of data (in the words of the directive, to "third countries").

A. So What Do We Do?

Right now:

- Work on a plan. The court's decision didn't provide a transition period, and therefore it takes effect immediately—all transfers from Europe to the United States under Safe Harbor since 6 October 2015 are illegal. However, the Commission and most of the data protection authorities across Europe have acknowledged already that it will take time for businesses to resolve this. We are waiting for the authorities, with support from the Commission and the Article 29 Working Party, to get their heads together to address how they are going to deal with it. In the meantime, authorities are responding to complaints and issuing requests for information. As a result, it is important to develop a plan so that you know what you need to do but also so that you can show a complaint or regulator that you are aware of the need to take action.
- Take stock. Map out your data flows. What information travels outside Europe? On what basis? Is it inter-group or is it to third parties? Are they using Safe Harbor as an exemption, or do you already have other comfort?

- Check your contracts with your third party suppliers who use Safe Harbor. Do they deal with this situation? It might be time to start a dialogue.
- Equally, if you are a supplier who relies on Safe Harbor to legitimize your processing activities, make sure this ruling doesn't put you in breach of any of your contracts, and perhaps consider reaching out to your affected customers.

And then:

- Take a look around. Once the dust has settled, options may seem clearer.
- Consider the options available to your business. In summary, at the present time they are:

– Stop transferring personal data to the United States. Site your servers in Europe, for example. This may be a draconian suggestion for some businesses, but for others it might be a relatively easy switch.

– Put in place Model Form Data Transfer Agreements (Standard Contractual Clauses). In many ways, these are a really easy fix. The European Commission has already drafted them for you, and you shouldn't change any of their terms. But they are legally binding documents that impose obligations on both parties which should be clearly understood—you shouldn't enter into them lightly. They also need to be entered into between data controller and data processor, and so for suppliers, this can be a time-consuming and paper-heavy process.

– Consider moving to Binding Corporate Rules (BCRs). Their inclusion in the new Data Protection Regulation is a sign post to their importance going forward. This shouldn't be a knee-jerk reaction, since BCRs require a corporate "buy-in" to the protection of personal data. But this is indeed their strength. In fact, businesses who took adherence to Safe Harbor seriously may find that they are a long way down the path to making the changes required for BCRs. They are not an overnight solution, however, since once you have your house in order, the negotiation process with the data protection authorities can take some months. Having said that, you may want to consider getting in quick before they are submersed in requests! However, even though BCRs are now enshrined in the new General Data Protection Regulation, due to come into force in 2018, some data protection authorities still don't accept them as a valid basis for transfer. Given this ambiguity, it is unclear how this will work during this transitional period.

– Remember that the European Union and the United States are already in negotiation over replacing Safe Harbor and no doubt a new urgent impetus has been injected into this process.

B. Response from Regulators

Regulators across Europe have taken different approaches to this development.

In the main, the response from the regulators has been measured. The Information Commissioner's Office (the "ICO"), the U.K. regulator, states that it will take businesses "some time" "to review how they ensure that data is transferred to the United States in line with the law," and that they will be working with other data regulators to issue guidance to help businesses. The ICO takes care to point out that this judgment does not indicate that there is any increase in threat to personal data, but that businesses must take steps to protect it.

The regulators, in their combined force as an Article 29 Working Party, have issued a useful and pragmatic statement. Although they are seeking a much better solution by the end of January 2016, they have confirmed that transfers under Model Contracts or Binding Corporate Rules are currently unaffected by the decision.

Germany stands out as an exception to this consensus. Germany has a number of data protection regulators—one for each region. The regulator based in Schleswig-Holstein has taken a rather contrary view, echoing the concerns that they have raised in the past regarding the Safe Harbor framework.

If you are transferring data from this region, the authority has stated that, at the present time, there are very few justifications for a transfer to the United States at the present time, and none that apply to employees. They have also noted their ability to fine up to €300,000 for any breach. Elements of the Schleswig-Holstein lead have been largely adopted by other German data protection authorities, who issued a joint statement on 26 October—but who still appear to permit transfers based on standard contractual clauses.

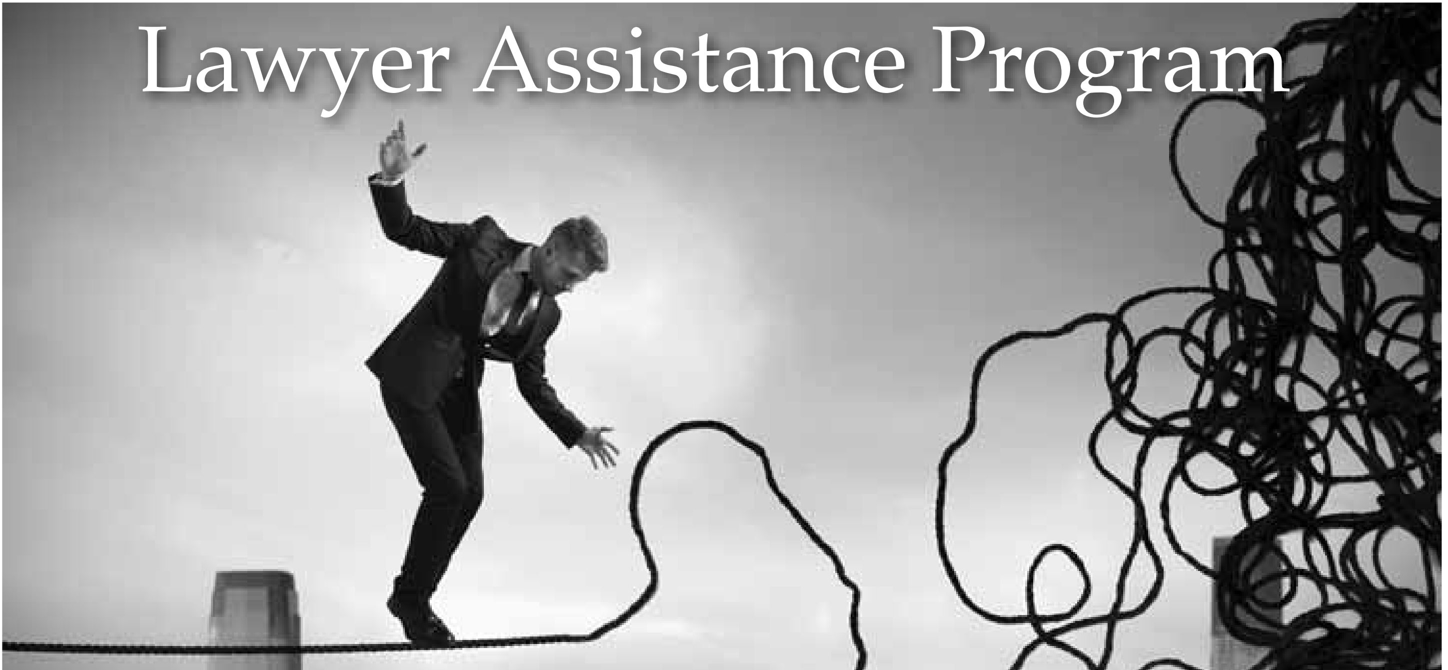
C. U.S. Response

On the U.S. side there are also some moves towards a more lasting solution. The U.S. House of Representatives agreed on 20 October 2015 to move forward the Judicial Redress Bill, which would seek to allow some foreigners the right to pursue their privacy rights in U.S. courts—one of the European Court's objections in the Schrems case. Congressman Jim Sensenbrenner, who introduced the Bill, said:

> The sudden termination of the Safe Harbor framework strikes a blow to U.S. businesses by complicating commercial data flows. If we fail to pass the Judicial Redress Act, we risk similar disruption to the sharing of law enforcement information. If we fail to pass the Judicial

Redress Act, we will undermine several important international agreements, further harm our businesses operating in Europe, and severely limit sharing of law enforcement information… The Judicial Redress Act currently enjoys broad support and has been endorsed by the Department of Justice as well as the U.S. Chamber of Commerce and numerous U.S. businesses… Let's put the President's infamous pen to good use signing this legislation.

Gayle McFarlane
Jonathan Armstrong
Andre Bywater
Cordery
London, England



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Law Report: Corruption in Sweden—A Bad Bout of Naiveté with a Bitter Cure

When asked by the press in late 2014 whether Skanska had paid out any bribes to Brazilian oil giant, Petrobras, its Latin American regional manager responded with a reassuring "Um, I don't know." In the same article, he also decried the corruption-rife business environment in his area, claiming it to be very difficult to navigate. Since then, and in parallel, TeliaSonera, which is listed on the OMX Nasdaq in Stockholm and is forty-percent owned by the Swedish state, has been in the media for its activities in Eurasia. Based on the media reports and the author's personal opinion, the Swedish company is at risk of facing exposure from the U.S. Department of Justice for its corrupt activities there. TeliaSonera may very well reach or surpass the Siemens record!

The statement by the Skanska representative could be written off as a regional manager without experience, or even a big company without a system to handle adequately compliance issues. But anyone who has worked in the anti-corruption field in Sweden can attest to the fact that Skanska, and its regional manager, are far from being the only ones lost at sea. In fact, Skanska has a reputation for being one of the most compliance-sensitive actors on the Swedish market. However, though Swedes may not seem particularly prone to corruption at home, they seem to be ill-prepared to deal with corrupt practices abroad, as may be proven by TeliaSonera. The tools and experience necessary to combat or even recognize bribery, money laundering and other corrupt practices are astoundingly rare in Sweden.

In all fairness, it is quite natural for a business to adopt local customs and values in order to adapt to the local market. It makes perfect sense to hire local talent familiar with how the market operates, and to recruit employees that have been exposed to the local norms since the day they were born. However, this laissez-faire policy of "when in Rome…," combined with the need to deliver results and the Swedish propensity to trust others and avoid "ruffling feathers," can be disastrous if there are no reliable systems in place to recognize what is and is not illegal. We have seen the model fail with Skanska—one of the few Swedish actors with a relatively strong culture against bribery. They have subsequently pulled out of India and Latin America altogether. We saw it fail when Saab was investigated for the events surrounding the selling of JAS airplanes in South Africa. We have seen it fail with Ericsson, whose Greek escapades are still under investigation. And, possibly the best example: we have seen it fail with TeliaSonera in the acquisition of a lucrative telecom license in Uzbekistan from a Gibraltar company owned by the Uzbek's president's daughter, which included TeliaSonera's cooperation with "leading families" in Azerbaijan, Kazakhstan, Georgia and Nepal. For a country that prides itself on its low public sector corruption rating, Sweden does not have a good track record when it comes to conducting business abroad.

The reason that Swedish companies keep experiencing these problems is because Swedes generally suffer from a severe bout of naiveté when it comes to corruption and its effects. It is very hard to fight what one does not know, and it is even harder to fight what one does not admit exists. Perhaps even more discouragingly, the Swedish political forces seem to share this lack of understanding about the seriousness of these issues, at least if one is to judge the legislation and resources—or lack thereof—assigned to combat corruption. A good example of the lack of understanding of the issue is how the Swedish Minister of Justice presented the "Swedish experience" when speaking on corruption with the former U.S. Ambassador to Sweden, Mark Brzezinski (link: http://www.tillsammansmotkorruption.se/almedalen-2015/2015/6/30/lunch pass), at a meeting held in 2015. This lack of understanding, and perhaps more importantly, the lack of clear ethical leadership at the government level, do not help Swedish companies get their act together. Not at all! The result is simply that it is much easier for both businesses and government agencies, already stretched thin, to simply turn a blind eye, blame local customs or proclaim it "just the cost of doing business." For companies in particular, an anti-corruption framework can be a costly investment for which there seems to be little return. Compliance is only worthwhile if there is a real chance that not investing will affect a business's bottom line. Toothless legislation and understaffed paper tiger agencies lead to an environment in which the kind of training and countermeasures necessary to combat corruption, especially in parts of the world that have very little in the way of systems for dealing with these issues, is simply not available.

The Swedish system suffers due to a limit on fines of 10m SEK, unclear jurisdictional rules, and police, prosecutors and judges that are as badly trained as the actors within the private sector. Under such a regime, it is not very difficult to imagine that the whistleblower hotlines, the compliance centers, the tone at the top and, perhaps most importantly of all, the employee training programs, end up on the cutting room floor in the budget discussions—if they were ever even mentioned. The answer to why Sweden is so far behind in the international race against corruption is another question, albeit a rhetorical

one: why pay money to comply with a system that, in practice, is not enforced when there is so much money to be had from skirting it instead?

While it cannot be denied that the Swedish system is moving forward, it does so at an erratic pace. The 2012 modifications to the Swedish Penal Code introduced some changes which may prove promising—particularly the "failure to prevent" concept—which at some point in time will bring compliance, and the need thereof, into the boardrooms of Swedish companies. New and more comprehensive EU-influenced anti-money laundering legislation will further stress the need of action.

Instead of looking to the Swedish rules, a concerned Swedish compliance officer should point to some unorthodox sources if she—here we assume it is a she—wants to provide her board with her business unit's *raison d'être*. Her strongest and most active allies, we argue, are located not within the Swedish government system, but in the United States and the United Kingdom. Indeed, all Swedish companies should bear in mind that paper tigers are not the only ones watching. The U.S. Department of Justice (DoJ) and U.S. Securities and Exchange Commission (SEC) have taken an increasing interest in foreign companies. Out of the ten largest settlements paid out to the DoJ and the SEC, non-U.S.-based companies paid eight. Seven of those eight were European. The Foreign Corrupt Practices Act (FCPA) may formally provide limited jurisdiction, but, in reality it does tend to include many of the larger non-U.S. corporations. However, more likely to shatter the Swedish sense of complacency is the Racketeer Influenced and Corrupt Organizations Act (RICO), giving the DoJ jurisdiction—at least in its own view—as soon as an American bank, the U.S. Postal Service or an American computer server is involved in a transaction or a message. Some hardliners might even argue that the use of the dollar as a currency gives jurisdiction—possibly explaining the rising popularity of the Euro as an international currency—although that might be taking it too far. Considering the broad scope of the term "foreign national," the DoJ has plenty of tools to wage a global war on corruption, should it have the inclination to do so, and there is reason to believe that it does. While the settlement of the AB Volvo case in 2008 was met with resounding silence from the Swedish press—and the American involvement in the TeliaSonera case has not caused much of a stir either—they remain strong indicators that the powerful American FCPA enforcement agencies are not afraid to flex their muscles.

Unfortunately, even the threat of agencies with such a draconian reputation as the DoJ and the SEC has not seemed to cause the frantic activity it rightly should have. One of the co-authors of this article entered into a polemic debate with a prominent member of the Confederation of Swedish Enterprise who simply refused to believe that the DoJ had jurisdiction in Sweden outside of a very narrow scope, a view that seems to be shared by the vast majority of Swedish actors. Luckily, for those of us with an interest in effectively combating corruption, we have several things working in our favor. Swedish legislation is moving forward. The anti-money laundering draft proposals have more teeth, and there are committee discussions of legislation to promote and protect whistleblowers. More and more companies are starting to understand the need for compliance by themselves, no doubt egged on by their anxious American colleagues. Lastly, with every new case, it is only a matter of time before the DoJ understands that the lax Swedish compliance culture leads to many more cases like TeliaSonera and more eyes are pried open. We do admit that, as lawyers, we can only advise our clients and have a very limited ability to lead the charge into a better tomorrow. It is, however, our duty to make sure that when Sweden's compliance culture finally matures, our practices have matured with it so that our clients are not left behind in the dust.

After all, even if the climate remains the same in Sweden, the powerful agencies of the United Kingdom, and especially the United States, will not go easy on a company they believe to be involved in corrupt practices. The far-reaching RICO Act, for instance, would allow the DoJ to pursue a Swedish company bribing a Swede in Sweden. It may well be time to realize that tomorrow is here—and has been here for a while—and that we in Sweden are already standing in the dust. That is not a position you want to be in, even if you happen to have plenty of company.

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Law Report: The Patent Box in Italy—Another Step to Encourage Innovative and Long Term Foreign Investments

I. Introduction

Following France, Belgium, Hungary, Luxembourg, Netherlands, Spain and the United Kingdom, Italy has recently introduced a Patent Box regime. This new tax arrangement is a key component of a wide range of reforms that the Renzi Government is bringing about to make Italy a more attractive country for foreign investment.

The Patent Box regime is a tax incentive designed to encourage companies to make profits from their intellectual property by reducing the tax paid on those profits. The objectives of the new legislation are to foster growth of investments in research and development (R&D) and ensure that intangibles are developed and maintained in Italy.

II. Favorable Corporate Tax

As a general rule, a corporate tax rate of 31.9 percent (27,5% IRES + 3,9% IRAP) applies to all companies operating in Italy. Substantial efforts have been made by the Italian Government to ensure that income related to the use of intellectual property enjoys a more favorable tax treatment. Pursuant to the Patent Box Regime, income derived from the use of intellectual property may enjoy a tax rate that at full regime is half of the ordinary corporate tax rate ("Patent Box Exemption"), provided that certain conditions are met.

The number of intangibles that qualify for this benefit is significant and includes:

- Software.
- Licensed Industrial Patents.
- Registered Trademarks.
- Models and Designs.
- Know-How.

As part of the Base Erosion and Profit Shifting project, all E.U. intellectual property (IP) regimes have been under review by the Organisation for Economic Cooperation & Development (OECD) and the Code of Conduct Group. The conditions to be met in order to qualify for the Italian Patent Box Exemption have been designed to comply with the OECD Action 5 Report.

The Action 5 report sets a minimum standard based on an agreed methodology to assess whether there is substantial activity to determine qualification for a preferential regime. In the context of intellectual property regimes such as patent boxes, consensus was reached on the *"nexus"* methodology. This approach uses expenditures in the country as a proxy for substantial activity and ensures that taxpayers benefiting from these regimes did, in fact, engage in R&D and did incur actual expenditures on such activities.[1] In addition to this, pursuant to the OECD BEPS ("Base Erosion and Profit Shifting Project") Action 5 Final Report, there is a sunset for software and know-how, which will not be included in the preferential regime after June 2016.

III. The "Nexus" Approach

The nexus approach aims to ensure that only companies actually engaged in significant R&D may enjoy the Patent Box Exemption. Interestingly, although designed to encourage R&D in Italy, corporate strategies that maximize the tax benefit by relocating the group's intellectual property to more tax friendly countries are discouraged.

The instrument used to incentivize R&D carried out at a company level is the Nexus Ratio. At first sight, the Nexus Ratio appears to be a complicated mathematical formula and it will likely create some issues for companies and professionals as they are learning to cope with it. However, from a theoretical standpoint, the policy that the BEPS Action 5 Report and the government aimed to pursue with the use of such an instrument is crystal clear: the tax exemption is allowed as long as R&D is not outsourced.

While the use of a mathematical formula may scare most lawyers, it is important not to overstate the difficulties in determining the Nexus Ratio. Once the underlying rationale is understood, finding out the ratio is pretty straightforward. The Nexus Ratio takes into account all direct (not ordinary) costs borne by a company in developing, improving and maintaining the intangible property ("Qualified Expenditures") and compares them with all the indirect expenditures incurred beyond the perimeter of the company ("Non-Qualified Expenditures"). Roughly speaking, the Nexus Ratio is a formula that expresses the proportion of R&D costs borne at the company level in order to create the intangible that qualifies for the tax benefit (save for some adjustments that take into account base research carried out by Universities or research centers as well as research joint ventures). The formula is as follows:

Nexus Ratio = (QE+Uplift) / (QE + NQE)

Expenses borne by other companies that belong to the same group of companies or are incurred to acquire a license or other intellectual property are "Non-Qualified Expenditures" and, if significant, will diminish the amount of the exemption. The Uplift is meant to allow a small degree of external expenditures that may not weigh

more than thirty percent of the total cost of the intangible in order for the Company to fully enjoy the Patent Box Exemption.

In substance, the Nexus Ratio is equal to one and the tax exemption is available in full in those scenarios where a company has internally developed its Intellectual Property. The Nexus Ratio is less than one (and the tax exemption is not fully enjoyed) where the intellectual property has been purchased, licensed from external sources, or developed in another company associated with the group.

IV. The Exempt Income

Any patent box arrangement raises the issue of identifying the scope of the exemption. There is a degree of inevitable uncertainty in the process of singling out the part of corporate income that may be deemed for tax purposes as the outcome of the use of the company's intellectual property. The OECD has identified several possible methods that companies may use to do so. The Italian Patent Box incorporates the international standards that require a self-assessment carried out at the company level. The self-assessment procedure must follow three steps: (1) identification of the qualified intellectual property; (2) assessing the income stemming from such intellectual property; and (3) undertaking the ruling procedure with the tax administration.

As indicated, the first step is to identify the company's intellectual property that may qualify for the exemption. As mentioned before, not all of the company's intellectual property may qualify for the exemption and it is important to properly identify what enters in the Patent Box.

The second step in the process is to assess the income related to the intellectual property that qualifies for the Patent Box. The most manageable way to deal with a Patent Box Arrangement is for a company to license its intellectual property to other companies that do not belong to the same group. In such a scenario the income related to the royalties for the licensed intellectual property are fully exempt and the self-assessment is quite straightforward. Unfortunately, in most part of the cases the company seeking a Patent Box Exemption will only have a portion of the income directly related with the use of its intellectual property that qualifies. In such a scenario, a company may use several methods of assessment in order to calculate the so-called "figurative income": *i.e.*, the income the company would have if it licensed its qualified intellectual property on the market. There are several available assessment methods to achieve this that have been articulated and approved by the OECD Transfer pricing guidelines.[2] The most commonly accepted methods are: (i) the "With or Without Method" (or premium profit method or branded vs unbranded); (ii) the "Relief from Royalties Method" (or profit split method); and (iii) the "Excess Earnings Method."

As indicated above, there is a third step that a company seeking a Patent Box Exemption must undertake. In order to foster certainty and avoid abuses, the company seeking a Patent Box Exemption has to enter the ruling procedure with the tax administration. The ruling procedure is mandatory for almost any self-assessment, except for those cases in which a company licenses its intellectual property to companies not belonging to the same group. During the ruling procedure, it is advisable to propose to the tax administration several assessment methods in order to prevent outright refusal of the exemption.

V. Conclusion

As the preceding discussion suggests, in the recent years the Italian government has shown an absolute resolve to foster R&D and encourage foreign direct investment. The Italian Patent Box has put Italy in line with other European countries and, along with other recent legislative innovation relating to start-ups, SMEs and tax credits for R&D, is an important step in making Italy more investment-friendly. The Patent Box, while of clear utility and interest for companies that invest in R&D, raises several issues that warrant consideration, some of which this article has set out to explore.

Endnotes

1. OECD/G20 Base Erosion and Profit Shifting Project. Explanatory Statement. 2015 Report.
2. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (July 2010).

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Law Report: International Legal Cooperation Act Enacted—Overview of Spain's New Regime on Judicial Assistance in Aid of Foreign Proceedings

I. Introduction

On 20 August 2015, Law 29/2015, of 30 July 2015 on international legal cooperation in civil matters (the "ILCA"), entered into force.[1] The ICLA provides Spain with a comprehensive regime for international legal cooperation in civil and commercial matters (including civil liability arising out of criminal offenses and labor contracts).[2] This regime is subordinate to the international treaties to which Spain is a party and to the international legal cooperation regime in place among European Union Member States.[3] Indeed, the ILCA is well aligned with the Hague Conference on Private International Law Conventions[4] and the European Union Regulations on these matters and further develops them.

In essence, the ILCA deals with: (i) recognition and enforcement of foreign court judgments and authentic instruments;[5] (ii) judicial assistance for the international service of process and the taking of evidence abroad (inbound and outbound); (iii) international lis pendens and related actions; (vi) recording of foreign court judgments and "authenticated instruments" in Spanish registries; and (v) access to information on foreign law and the means to prove foreign law before Spanish courts.

The ILCA is based on an underlying principle that favors international legal cooperation, even in the absence of reciprocity. It is aimed at guaranteeing effective access to justice. In this light, it may be particularly relevant to proceedings in jurisdictions where there is no judicial cooperation treaty in place, such as the United States.

II. Recognition and Enforcement of Foreign Judgments' Main Features

Pursuant to the ICLA, recognition (exequatur)[6] of final (*i.e.*, non-appealable) foreign court resolutions can be granted provided that:

(i) the judgment is not contrary to public policy;

(ii) the exclusive jurisdiction of the Spanish courts is not violated;

(iii) the court of the country of origin is a court of competent jurisdiction according to Spanish rules on international jurisdiction and generally accepted principles;

(iv) there has not been a manifest breach of the procedural rights of any of the parties. In particular, if the judgment is entered in default of appearance, it will not be recognized if the defendant was not duly served with the document that instituted the proceedings, or with an equivalent document, in sufficient time to enable him or her to arrange for his defense;

(v) the foreign judgment is not irreconcilable with a Spanish judgment or with a previous foreign judgment that complies with the requirements to be recognized in Spain; and

(vi) there is no pending dispute before a Spanish court involving the same parties and the same cause of action. For this ground to be relevant, the proceedings before the Spanish court must have commenced prior to the proceedings before the foreign court.

Interim and provisional measures adopted by foreign courts may also be recognized and enforced, provided they are not ex parte, and that non-recognition would deprive the petitioner of the legal effective remedy to which it is prima facie entitled.

Recognition (exequatur) and enforcement petitions will now be brought before courts of first instance, and they may be dealt with in the same proceeding. The court of first instance will grant the exequatur first and subsequently order enforcement of the foreign judgment.[7] The court must recognize every relevant section of the judgment not affected by non-recognition grounds.

Although the substance of the foreign judgment cannot be reviewed, the judge may, if necessary for enforcement, adapt any measure unknown in the Spanish legal system to a known measure with equivalent effects and similar purposes.

In order for a foreign judgment rendered in a class action suit to be recognized and enforced against class members that did not expressly opt in, the ILCA requires that (i) the lawsuit was notified or published in Spain by equivalent means as those required under Spanish law and (ii) class members have been afforded the same opportunities as those domiciled in the country of origin to decide whether to participate in the class action.

On another note, under the ILCA an authentic instrument that is enforceable in the State of origin will be enforceable in Spain, provided it is not contrary to Spain's public policy. The same applies to court settlements.

III. International Service of Process and the Taking of Evidence

In addition to the traditional channels for the transmission and reception of requests for judicial assistance (central authorities,[8] diplomatic and consular agents), the ILCA provides for direct communication between the Spanish courts and the courts of the other state, to the extent that such direct communication is allowed under the law of the other state.

Moreover, the ILCA allows the foreign authority to use postal channels (or equivalent means) with acknowledgment of receipt for transmittal directly to the addressee in Spain.

With regard to the taking of evidence and the traditional battlefront of pre-trial discovery of documents, the ILCA follows the general solutions articulated by the Hague Conference. Accordingly, petitions for disclosure of documents will be honored if the documents are reasonably identified and proof that they are in possession, custody or power of the requested party has been provided.

Requests for judicial assistance must be translated into Spanish. Documents included within the request (*e.g.*, any documents to be transmitted to the addressee) must be either in Spanish, or in one of the other official languages of the regional subdivision within Spain[9] where the recipient is to be found, or in a language that the recipient understands.

In order to protect personal data, requests for judicial cooperation will include the minimum personal data necessary and use of personal data is restricted to what is necessary for the proper execution of the request.

IV. International Lis Pendens and Related Actions

The ILCA introduces a mechanism for resolving cases of international lis pendens and related actions not governed by EU Regulation 1215/2012. Under the ILCA, the Spanish judiciary may stay proceedings, provided that (i) the Spanish courts were seised after the concurrent foreign court, and (ii) certain conditions, mainly related to the proper administration of justice, are met.

Endnotes

1. Published in Spain's *Official Gazette* on 31 July 2015.
2. Law 29/2015 plays an important role in systematizing the state of the law of Spain's international judicial assistance regime stemming from different legal sources such as some provisions from the Law on Civil Procedure of 1881, resolution of 15 September 2005 of the General Council of the Judiciary, internal practices by the Spanish Central Authority, as well as case law.
3. http://ec.europa.eu/justice_home/judicialatlascivil/html/ds_information_en.htm.
4. https://www.hcch.net.
5. In line with the definitions provided in E.U. regulations, an ILCA "authentic instrument" is a document which has been formally drawn up or registered as an authentic instrument in the State of origin and whose authenticity (i) relates to the signature and the content of the instrument and (ii) has been established by a public authority or other authority empowered for that purpose.
6. *Exequatur* means the declaration by Spanish courts that a foreign judgment is recognized within the Spanish legal system and that it is enforceable (*i.e.*, that it may be considered for enforcement proceedings as if it were a Spanish judgment).
7. This is in contrast to the previous regime, providing for a two-step process involving an action for recognition of the foreign judge's decision before Spain's highest court in civil matters—*i.e.*, the Supreme Court—and a subsequent action for enforcement before Spain's first instance courts.
8. The organ and/or entity appointed by the state to transmit and receive requests for judicial assistance.
9. *I.e.*, Spanish, Catalan and Occitan languages in Catalonia; Spanish and Catalan in the Balearic Islands; Spanish and Valencian in Valencian Community; Spanish and Galician in Galicia; Spanish and Basque in the Basque Country.

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Law Report: New Reinsurance Regulation in Brazil

I. Brief Historical Overview

A historical overview of the reinsurance environment in Brazil is helpful to understand the impact of the new reinsurance regulation issued in 2015.

Reinsurance was contracted abroad or through foreign companies operating in Brazil until 1939, when the Brazilian monopolist reinsurer ("IRB") started operating. The purpose of IRB's creation was to strengthen and expand the risk retention capacity of the few existing domestic insurers, as well as to reduce Brazil's outflow of foreign exchange and dependence on foreign capital. During that period, Brazil was going through an intense industrialization process and demanded insurance and reinsurance protection. Clearly IRB had a key role in the Brazilian economy.

The monopolistic reinsurance activity was programmed to support the expansion of the insurance market, and the protection of national insurers was justified as a way to compensate for their lower levels of capitalization and technical capacity compared to international players. This was the driver of closed Latin American economies between 1940 and 1970.

The first attempt at opening the reinsurance market in Brazil occurred through Constitutional Amendment No. 13 in 1996 through the breaking of the monopoly exercised by the IRB, but with no practical effects. As a result, IRB continued to be the only reinsurance player in Brazil.

There were other attempts throughout the years but the opening of the reinsurance market in Brazil finally occurred with the issuance of Complementary Law No. 126 of 2007 and Resolution No. 168 of 2007. This was a significant change in the competition of the reinsurance sector which created a positive environment for capital injection, inflow of foreign investments, increase of sophisticated insurance transactions, and improvement in the technical efficiency and skills of reinsurers, brokers and insurers.

II. Regulatory Overview Post Opening of the Reinsurance Market

The structure established by Complementary Law No. 126 of 2007 and Resolution No. 168 of 2007 allowed Brazilian reinsurance companies (called "local reinsurers") and foreign reinsurance companies (called "admitted reinsurer" and "occasional reinsurer") to operate in the same market. Local companies had the advantage of preferential offering, while cessions to occasional reinsurers were limited.

Three years later, Resolution No. 225 of 2010 and Resolution 232 of 2011 were enacted, which limited the degree to which non-Brazilian reinsurers could reinsure Brazilian risks. Under these regulations, forty percent of reinsurance business should be placed with Brazilian reinsurers and local insurers. Additionally, reinsurers were prohibited from ceding more than twenty percent of premiums to affiliated, intragroup reinsurers located abroad. As a result, the regulation continued to protect domestic insurers and reinsurers while simultaneously restricting market access to foreign-affiliated reinsurers.

This was an unexpected twist in the market and some players felt the investments already made after the opening of the Brazilian reinsurance market were no longer attractive compared to other territories.

Finally, in 2015, the Brazilian insurance regulator issued Resolution No. 322 of 2015, establishing new limits in connection with cross-border intragroup reinsurance cessions and introducing new rules for the mandatory offering of insurance risk to local reinsurers.

III. New Reinsurance Regulation—Resolution No. 322 of 2015

Resolution No. 322 of 2015 amended Resolution No. 168 of 2007 and revoked the previous Resolution No. 232 of 2011, which restricted an insurance company or local reinsurer to transferring no more than twenty percent of premiums corresponding to each coverage it contracted to related companies, or to companies belonging to the same financial conglomerate.

This new regulation established a progressive increase in such percentage, gradually relaxing the limits on premium which may be contracted to related companies or to companies belonging to the same financial conglomerate headquartered abroad. The new limits changed to:

— twenty percent until 31 December 2016;

— thirty percent from 1 January 2017;

— forty-five percent from 1 January 2018;

— sixty percent from 1 January 2019;

— seventy five percent from 1 January 2020.

Resolution No. 322 of 2015 also regulates cession of risks to local reinsurers. Pursuant to prior regulations, insurance companies must contract with local reinsurers at least forty percent of each reinsurance cession whether through treaties or facultative contracts.

The preferential offer of forty percent of each reinsurance cession to local reinsurers remains unchanged. However, the minimum mandatory cession to local reinsurers will be gradually reduced as follows:

— forty percent until 31 December 2016;

— thirty percent from 1 January 2017;

— twenty-five percent from 1 January 2018;

— twenty percent from 1 January 2019;

— fifteen percent from 1 January 2020.

Lastly, the new regulation establishes a consulting committee to be comprised of members of the government and experts in the reinsurance field. This committee will be responsible for: (i) identifying potential inconsistencies between Brazilian reinsurance rules and global reinsurance best prac-

tices; and (ii) proposing corrective measures within one hundred and twenty days after its creation. This is being considered a significant commitment on the part of the regulator to understand from market players what are these differences and their impacts and to eliminate or maintain them.

In conclusion, the enactment of Resolution No. 322 of 2015 is a positive step in the right direction of competitive market and exposure to foreign investment. The progressive restriction reduction to intra-group operations is an admirable step by the regulator toward the alignment of Brazil's reinsurance regulatory system with international best practices.

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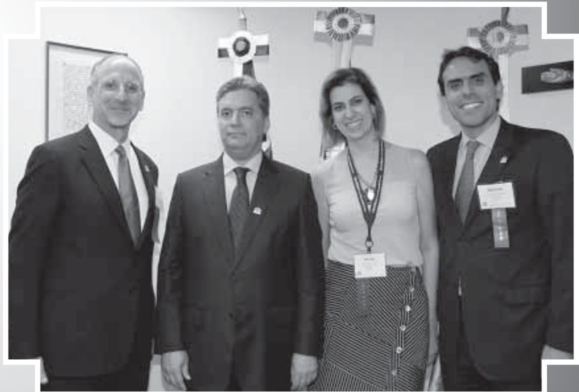

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