

International Law Practicum

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Practicing the Law of the World from New York

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EU Merger Control

By Michael Barnert

1. Introduction and Historical Preview

A. The Merger Regulation

On 21 December 1989, the Council adopted the Commission's proposal of a Council Regulation (EC) No 4064/89 on the control of concentrations between undertakings, generally referred to as the Merger Regulation ("Merger Regulation"). Since its entry into force on 21 September 1990, it has been providing the basis for the control of concentrations with a Community dimension in the European Union.

Given the fact that the EEC Treaty does not contain provisions dealing specifically with mergers and that the Commission found the existing competition rules inadequate to tackle the entire concentration phenomenon at a Community level, it seems only logical that already in 1973 the Commission presented its first proposal for a specific regulation dealing with concentrations between undertakings. However, the issue was controversial, since opinions differed substantially between Member States on the extent to which concentrations should be controlled at the Community, as opposed to the national, level.

With this factual background it was not surprising that it took almost another one and a half decades—when the progress made toward completing the internal market and a new political environment had provided the key impetus toward approval of a merger control regulation—until the Commission proposed an updated proposal in Autumn 1987, which finally led to the adoption of the merger control regulation.

Since its entry into force, the principles laid down in the Merger Regulation have been developed through case law and practice of the European Commission as well as the European Court of Justice (Court of First Instance). The experience of the first years was finally reflected in the first amendment to the Merger Regulation (EC No 1310/97), adopted on 30 June 1997. While the overall system and the main principles governing the Merger Regulation remained unchanged, some adaptations have been found necessary. This applies in particular to the thresholds for determining the Community dimension of transactions and the applicability of the Merger Regulation to joint ventures. Thus, an additional set of lower thresholds was introduced—thereby also applying to smaller operations that might otherwise have to be filed with the respective competition authorities in several different Member States—and the scope of the Merger Regulation was extended to all

full-function joint ventures meeting the turnover thresholds under the Merger Regulation.

B. Implementing Regulation

The Merger Regulation provides for the Commission to adopt implementing provisions. The Commission made use of this power in 1989 to adopt the first Implementing Regulation, which was replaced by the second Implementing Regulation of 1994. However, in the light of the amendments to the Merger Regulation and the Commission's experience with the earlier Implementing Regulation, the Commission adopted a third Implementing Regulation with Commission Regulation (EC) 447/98 on 1 March 1998, which is in force at present.

The Implementing Regulation lays down rules regarding the notifications, time limits and hearings provided for in the Merger Regulation.

C. Interpretative Notices

In order to give some guidance to the parties applying the merger rules and to foster transparency with regard to its own practice in applying and interpreting the provisions of the Merger Regulation, the European Commission has adopted a number of interpretative notices over the years since the Merger Regulation first entered into force. Currently there exist seven interpretative notices covering the main issues arising in connection with the application of the Merger Regulation:

- Commission notice on the concept of full-function joint ventures (OJ C 66, 2 March 1998, p.1).
- Commission notice regarding restrictions ancillary to concentrations (OJ C 203, 14 August 1990, p.5).
- Commission notice on the concept of concentration (OJ C 66, 2 March 1998, p.5).
- Commission notice on the concept of undertakings concerned (OJ C 66, 2 March 1998, p.14).
- Commission notice on the calculation of turnover (OJ C 66, 2 March 1998, p.25).
- Commission notice on the definition of the relevant market (OJ C 372, 9 December 1997).
- Commission notice concerning the alignment of procedures for processing mergers under ECSC and EC Treaties (OJ C 66, 2 March 1998, p.36).

II. The System of the Merger Regulation

Under certain conditions, mergers, acquisitions and other transactions which constitute a “concentration” within the meaning of the Merger Regulation must be notified to the European Commission. As a basic principle, if the Merger Regulation is applicable, this will exclude the applicability of any national merger control rules, *i.e.*, the Merger Regulation provides “one stop shopping” for the clearance of the transaction concerned. There are, however, exceptions to this principle: On the one hand, under Article 9 of the Merger Regulation the Commission may refer a case to a national competition authority where the effects of the concentration are felt on a market within this Member State which presents all the characteristics of a distinct market; on the other hand, Art 22 (3) provides for the Commission to exceptionally decide on merger cases without a Community dimension, if one or two Member States request her to do so.

The main conditions which must be fulfilled in order for EU merger control to apply to a given transaction are twofold: First, the envisaged transaction must constitute a “concentration.” This depends on the nature of the transaction and more specifically on the question whether a transaction entails a change of control over a company. Second, the turnover of the undertakings concerned has to meet the turnover thresholds as provided for in the Merger Regulation.

A. The Concept of Concentration

According to the Merger Regulation, a concentration shall be deemed to arise where two or more previously independent undertakings merge or one or more undertakings acquire direct or indirect control of the whole or a part of one or more other undertakings. In other words, the Merger Regulation aims to catch changes of control of companies. This means that it potentially applies to acquisitions of the whole or parts of companies, certain types of joint ventures and full mergers of companies.

An acquisition of companies effected by means of the transfer of shares, assets or by any other means leading to change of control may lead to the applicability of the Merger Regulation, whereas control is defined as “the possibility of exercising decisive influence on an undertaking.”

A joint venture will fall within the Merger Regulation if it is jointly controlled by two or more parent companies and if it is a so-called full-function joint venture. A joint venture will be deemed to be full-function if it “performs on a lasting basis all the functions of an autonomous economic entity.” This will require that the joint venture brings about a lasting change in the struc-

ture of the undertakings concerned. Furthermore, the joint venture must operate in the market in a similar way to other undertakings operating on the same market and have its own management as well as sufficient resources in terms of finance, staff and assets to conduct its business.

B. Thresholds

The scope of the Merger Regulation is confined to concentrations with a “Community dimension.”

First, a concentration has a Community dimension where

- the combined aggregate worldwide turnover of all participating undertakings is more than EURO 5 billion, and
- the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EURO 250 million,

unless each of the participating undertakings achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State of the Community.

Furthermore, a transaction will have a Community dimension in the sense of the Merger Regulation where:

- the combined aggregate worldwide turnover of all undertakings concerned is more than EURO 2.5 billion and
- in each of at least three Member States the combined aggregate turnover of all the undertakings concerned is more than EURO 100 million, and
- in each of these three Member States included for this purpose the aggregate turnover of each of at least two of the undertakings concerned is more than EURO 25 million, and
- the aggregate Community-wide turnover of each of at least two of the undertakings is more than EURO 100 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover in one and the same Member State.

For the purpose of calculating the thresholds, it is necessary to understand the meaning of the term “undertakings concerned,” which will regularly depend on the type of transaction involved. In the case of an acquisition of sole control of a whole company, the undertakings concerned will be the acquirer and the acquired company. In the case of an acquisition of part of a company, the undertakings concerned will be the acquirer and the part of the company acquired. The

seller will not be considered as an undertaking concerned unless it retains joint control of the company being acquired. In the case of acquisition of joint control of a newly created joint venture, the undertakings concerned will be the parent companies of the joint venture. If the company which becomes the joint venture is a pre-existing company, it will, together with the parent companies, also be an undertaking concerned to the extent that its turnover has to be added to the parent company's turnover.

In all cases, except for the acquisition of only part of an undertaking, if the undertakings concerned are part of a group, the relevant turnover for the purpose of calculating the thresholds is the whole group turnover.

III. Procedure

A. Notification

Where the participants of a proposed transaction fulfill the two main criteria of "concentration" and "Community dimension" as described above, a notification must be filed with the Commission's Directorate Competition (the former Directorate General IV), Directorate B (Merger Task Force). For notifications the use of the Form CO (together with twenty-four copies), as provided for in the Implementing Regulation, is mandatory.

In the case of an acquisition of the whole or a part of another company, the obligation to notify lies with the acquirer. In the case of a joint venture, the jointly controlling parent companies will be responsible for the notification. Where two or more previously independent companies merge, they must also make a joint notification to the Commission.

The notification of a transaction falling within the Merger Regulation must be made not later than one week after the "conclusion" (*i.e.*, signing) of the agreement(s) bringing about the transaction or the announcement of a public bid as applicable. However, this deadline may—and normally will—be extended on prior request to the Commission. Furthermore, it is usual practice to have a so-called confidential guidance meeting with the Commission prior to the formal notification in order to ensure that the process of merger clearance can be completed as smoothly as possible.

Before clearance of the notified transaction by the Commission (or the Commission's failure to come to a decision within given time limits, as discussed below), the parties are generally not entitled to consummate the transaction. Failure to respect this obligation may lead to the parties being fined and will lead to the civil invalidity of the transaction.

B. The Commission's Assessment

After receipt of a complete notification, the Commission will assess the planned transaction. In doing so, the Commission is bound to the rather short deadlines provided for in the Merger Regulation, which speed up the assessment process in order to avoid any unnecessary further delay in the consummation of the transaction.

1. First Phase

From the date of the notification, the Commission has a period of one month for an initial assessment of the notified transaction.

This period is extended to six weeks if the undertakings concerned submit commitments with the purpose of rendering the notification compatible. This period will also be extended to six weeks whenever a Member State makes use of the possibility to request referral of the matter within three weeks of the notification.

The Commission's assessment in the first phase may lead to three different types of decisions:

- The transaction does not fall within the jurisdiction of the Merger Regulation.
- The transaction raises no serious doubts as to its compatibility.
- The concentration raises serious doubts as to its compatibility.

However, if the Commission does not make a decision within this period, the operation will be deemed to have been declared compatible.

2. Second Phase

If in the first phase, the Commission has raised serious doubts as to the compatibility of a concentration with the Common Market, it will undertake a more detailed, second phase investigation, for which a further four months is allowed. Within three months, the parties may submit commitments in view of rendering the transaction compatible.

If the Commission intends to declare a concentration incompatible, it has to issue a statement of objections to the notifying parties. In this case, the parties directly involved have the right to access to the file and to ask for a formal oral hearing. Before taking any decision, the Commission must consult the Advisory Committee on Concentrations, in which the Member States are represented. Finally, the Commission will close its second phase investigation by declaring the concentration either compatible, incompatible or compatible with

the Common Market subject to certain conditions and obligations. However, if the Commission does not take a decision within the period of four months, the concentration will be deemed to have been declared compatible.

The Commission's final decision may be appealed under the relevant provisions of the EC Treaty to the European Court of Justice (Court of First Instance).

IV. Outlook and Possible Reforms

Since the adoption of the Merger Regulation, the number of merger cases has been constantly on the rise. By April 1999, the Commission had received more than one thousand notifications under the Merger Regulation. While the Commission's Directorate of Competition is able at the moment to deal with all notified mergers, the accession of new Member States and the further integration of European markets will certainly bring about a further increase in notifications to the Commission. The EURO 250 million threshold Community turnover will be more easily attained and the likelihood that the current two-thirds rule is applicable will decrease. This could make it increasingly difficult for the Commission to handle all notified cases with the

required care while remaining within the tight time limits of the Merger Regulation.

Art. 1 (4) of the Merger Regulation obliges the Commission to report to the Council on the operation of the thresholds and criteria set out in Art 1 (2) and (3) before 1 July 2000. Moreover, Art 9 (10) states that the provisions on the referral of cases to Member States may be re-examined at the same time. The Commission is therefore in any event obliged to reflect upon these two key elements that define its jurisdiction on mergers on a Community level. While such a review will not necessarily lead to a reform going beyond jurisdictional issues, the Commission might well take the opportunity to come up with a blueprint for further-reaching proposals. This will, however, not only depend on whether deficiencies in the current system are identified and formulated by the Commission or by the other interested parties, but also on the actual political readiness for and feasibility of a further reform of the European Merger Regulation.

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International Law and Practice Section **SEASONAL SECTION MEETING 2000** Madrid, Spain • October 25-29, 2000

Bridging the Atlantic: Impact of Recent Trade Agreements on International Practice

The NYSBA International Law and Practice Section cordially invites you to attend its Seasonal 2000 Meeting in Madrid, Spain at the "essence of Spain," the Palace Hotel, centrally located across from the Prado and Thyssen museums and a stone's throw from the city's Retiro Park.

The meeting will feature a diverse program touching many areas of practice that are becoming increasingly international. In addition, the recent signing of the EU-Mexico Trade Agreement, to become effective in July 2000, will have a major impact on the countries on both sides of the Atlantic, including Canada (NAFTA), Argentina, Brazil, Chile, etc. (MERCOSUR), Central American and Caribbean countries (CARICOM) and North African (MAGREB). The meeting will examine that effect and its implications for your clients and the legal profession.

We are seeking the cooperation of Spain's National Bar Association and the Madrid Bar Association, and speakers and participants are expected from Europe, Mexico, Central, South and North America.

In addition, activities will be offered to take full advantage of Madrid's unique culture. Participants will have opportunities to visit nearby cities, including Toledo, Segovia, Avila and Chinchon. A side-trip to Barcelona is also planned prior to the meeting.

We look forward to seeing you in October. Mark your calendars!

A Brief Review of Merger Control in the United States

By Peter Bowman Rutledge

I. Introduction

A. Overview

The specific topic of my remarks is the United States experience within the general subject of merger control. To design such an address is, in some respects, a difficult enterprise. Thousands of pages have been written—and many more could be written—on the American system of merger control. One cannot hope to review and comment on this entire corpus in an address of this sort. Moreover, in a comparative law presentation, the address must be sufficiently detailed to permit comparisons to other legal regimes but also sufficiently general to provide an accessible overview to those unfamiliar with the American merger control system. My hope is that the following observations on the American system will help to supply some benchmarks for comparison with the regimes in the European Union and Eastern Europe.

B. The Business Problem

In approaching the topic of merger control, I am reminded of a comment from one of my old law teachers, Professor Richard Epstein. He used to tell us that one cannot understand a *legal problem* without first trying to understand the underlying *business problem* it is trying to address. While perhaps sounding simple in the abstract, this comment helps bring into relief the debate over first principles that often underpin any legal issue. In the context of antitrust, and specifically merger control, the question of what are (or should be) the underlying purposes is a hotly disputed one—whether the purpose of such regulation is to promote competition, protect consumers, advance industrial policy, or achieve some entirely different goal. With Professor Epstein's adage in mind, I wish to posit, for now, that the basic business problem for merger control is essentially one of how to promote competition: namely, how to combat the anti-competitive dangers posed by some mergers which could result in monopolistic or oligopolistic behavior while simultaneously not eliminating the competitive benefits provided by others which could offer improved efficiencies or economies of scale.

C. Historical Synopsis

Against this backdrop, the history of American merger control is rooted in various attempts to regulate effectively anti-competitive business activities. The earliest species of antitrust regulation emerged from vari-

ous English and American common law doctrines of contract law. Since these doctrines only served as defenses to contract enforcement, they were especially poor instruments for combating the more general effects of anti-competitive activity on a given market. In the nineteenth century, state governments launched the first attempts at more general antitrust regulation. But frustration with the inefficacy of state regulation and reaction to the ascendancy of "trusts" led to the enactment of the Sherman Anti-Trust Act of 1890. Phrased in sweeping terms, the Sherman Act prohibited "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade" and also punished monopolies or attempts or conspiracies to form the same.¹

Though broadly cast, the Sherman Act (the original federal tool for attacking mergers) eventually proved ineffective, partly due to the gloss given by the courts, and Congress in 1914 responded with two important pieces of legislation affecting federal merger control. First, the Clayton Act prohibited various forms of anti-competitive activity, including the acquisition of a competitor's stock where its effect would be to lessen competition or create a monopoly; it also authorized private parties injured by a violation of the Sherman or Clayton Act to sue for treble damages. Second, the Federal Trade Commission Act prohibited "unfair methods of competition in or affecting commerce" and created the Federal Trade Commission, a quasi-independent administrative agency charged with exclusively enforcing the Act's provisions.

While the Clayton Act supplied a legislative attempt to address merger control, its perceived deficiencies again led to calls for legislative change. By its terms, the Clayton Act only applied to share transfers, not asset acquisitions; moreover, the law arguably failed to address non-horizontal mergers. In 1950, Congress again responded with the Celler-Kefauver Act, broadening the Clayton Act's proscriptions to include asset acquisitions and also specifying that its mandate extended to a reduction in competition "in any line of commerce" and "in any section of the country." Vigorous enforcement of the Clayton Act soon followed, and in 1968 the Department of Justice issued its first set of merger control guidelines. Against the background of the business problem described above, the guidelines attempted to provide businesses with some notice about when the federal government viewed a merger or

acquisition as posing an unacceptable threat to competition despite its efficiencies. This model of issuing public pre-enforcement guidelines marked an important development in public merger control and supplies the paradigm for many current efforts at public enforcement.

The next significant development came in 1976 with the passage of the Hart-Scott-Rodino Antitrust Improvements Act. Complementing the system of merger guidelines, which placed a premium on notice, the Hart-Scott-Rodino Act expanded the investigatory power of the Department of Justice, required notification after public announcement of a proposed combination, and established a waiting period to enable enforcement authorities, including both the Justice Department and the Federal Trade Commission, to investigate the combination's likely competitive effects. The Act erected various thresholds for the types of acquisitions that would trigger its notification requirement (provided that they did not fall under one of its exemptions), authorized enforcement authorities to obtain preliminary injunctions in the event they wished to oppose an acquisition, and created a schedule of steep penalties for noncompliance. Additionally, it authorized state attorneys general to initiate suits on behalf of their citizens.

Since the enactment of the Hart-Scott-Rodino Act, the Justice Department and Federal Trade Commission have issued several sets of revised guidelines as well as guidelines covering specific areas such as health care, intellectual property, and foreign operations.

II. Legal Regime

A. Scope

A panoply of different laws, both federal and state, may bear on a proposed merger. For purposes of this discussion, however, I wish to focus on the predominant piece of federal legislation—the Clayton Act, as amended by the Hart-Scott-Rodino Act—and the applicable merger guidelines, especially the horizontal ones. For purposes of completeness, however, several other laws deserve brief mention.

In addition to the generally applicable Sherman Act and Federal Trade Commission Act, other laws may bear on a particular transaction depending on factors such as the parties' identities and the industry involved. Other federal laws include the Exon-Florio Amendment of 1988 (governing mergers by or with foreign persons in matters affecting national security);² the Bank Merger Act;³ the Bank Holding Company Act;⁴ and the Newspaper Preservation Act.⁵

Overlapping with the federal legislation, several states have enacted their own merger control statutes,

which federal law apparently does not preempt.⁶ State attorneys general, however, also may employ the Clayton Act due to Section 4's *parens patriae* provisions.⁷ Finally, the National Association of Attorneys General has issued its own set of horizontal merger guidelines, similar in several respects to the DOJ/FTC guidelines. Like the joint agency guidelines, the NAAG guidelines provide some signals as to when a state attorney general may challenge a merger. Since filings under the Hart-Scott-Rodino Act are exempt from public disclosure, the NAAG also encourages businesses voluntarily to file a single merger notice in an attempt to avoid repetitive information requests from multiple state attorneys general.⁸ Having briefly canvassed these other authorities, I wish to bracket them for purposes of this discussion and focus instead on the Clayton Act and the general merger guidelines.

B. General Substantive Standards

In analyzing the standards governing a merger, one must distinguish between two different questions. First, there is the substantive question of what standards will determine the likelihood of an agency challenge and the prospects for success in the event of judicial review. Second, there is the procedural question of what mergers are subject to the premerger notification and waiting periods erected under the Hart-Scott-Rodino Act. Allow me to focus initially on the first question.

The substantive prohibition embraced in the Clayton Act is broadly phrased. In general, it provides that, assuming certain jurisdictional requirements are satisfied, no entity shall acquire the stock or assets of another, in whole or in part, where the effect of such an acquisition may be substantially to lessen competition or to tend to create a monopoly in any section of the country and in any line of commerce. This fairly dense standard leaves many concepts open to interpretation through judicial or agency decision, including, most notably, the definition of the relevant geographic and product markets and the meaning of "lessen[ing] of competition." Following the enactment of the 1950 amendments to the Clayton Act, several Supreme Court decisions offered varying judicial glosses on these concepts, including *United States v. General Dynamics Corp.*⁹ and *Brown Shoe Co. v. United States*.¹⁰ More recently, the DOJ/FTC guidelines have become an increasingly important tool for interpreting this language, due principally to these agencies' threshold role in enforcement decisions. It is important, however, to keep the statutory and agency standards distinct. The guidelines technically lack any legal force whatsoever: for Section 7 cases initiated by private plaintiffs or not settled with federal authorities, a federal court will apply its own principles developed through case law, and traditional principles

of agency deference do not apply, although the courts periodically look to the Guidelines. However, given the importance of the agencies' views on this subject, I now examine these in greater detail.

C. Merger Control Guidelines

The relevant enforcement agencies have issued multiple sets of guidelines governing different types of mergers and, in some cases, particular industries. Since the Horizontal Merger Guidelines are frequently at issue and introduce several common concepts, I will focus on those and then briefly highlight some of the distinct precepts governing nonhorizontal combinations. According to the Guidelines, the ultimate inquiry is whether a merger "create[s] or enhance[s] market power or [] facilitate[s] its exercise."¹¹ Ordinarily this inquiry proceeds in several steps. First, the agencies ask whether a merger would significantly increase concentration and result in a concentrated market. Second, they consider whether the merger, in light of market concentration and other factors, raises concerns about potential adverse competitive effects. Finally, mitigating factors are considered: the ease of other participants' entry; possible efficiency gains generated by the merger; and whether the merger is a necessary alternative to a failing company's exit from the market.

Market definition plays a central role in the analysis under the Guidelines, for it is from the market definition that the agencies then measure concentration. Under the Guidelines, markets are defined along two axes: product market and geographic market. With respect to each product produced by each merging firm, the Guidelines define the market by reference to consumer demand responses; specifically when could a hypothetical profit-maximizing firm impose a "small but significant and nontransitory" price increase (defined generally as five percent), assuming that other terms of the sale were held constant. In defining expected consumer responses, the agencies purport to take all relevant evidence into account, including evidence of buyers' behavior, sellers' business decisions, the influence of downstream competition, and the timing and costs of switching suppliers. Some adjustment in these measures is made in cases of price discrimination.

Once the relevant markets have been defined, the Guidelines then explain how to ascertain market shares and market concentration. Market participants include all firms that currently sell or produce in the relevant market, firms that offer reconditioned or recycled goods (where appropriate), and other firms not currently participating ("uncommitted entrants") where their inclusion would more accurately reflect probable supply-side responses. Market concentration is generally measured using the well known Herfindahl-

Hirschman Index ("HHI"). Under the HHI, market concentration is calculated by totaling the squares of each firm's market share: thus a pure monopoly would have an HHI of ten thousand, while an atomistic market would have an HHI of zero. Unlike previous measures of market concentration (where courts totaled the market shares of the four largest firms or agencies looked to the market shares of the merger participants), the HHI, by squaring the market shares, inflates the concentration figure where one or more firms has a substantial market share.¹²

Under the Guidelines, the post-merger HHI and the expected change in concentration attributable to the merger influences the likelihood that the agencies will challenge it. Where a market's post-merger HHI is below 1000, the agencies regard the market as relatively unconcentrated. Where the HHI is between 1000 and 1800, the likelihood of an agency response depends on whether the merger produces an increase of more than 100 points. Finally, where the post-merger HHI exceeds 1800, an increase of more than 50 points is likely to warrant further analysis, while an increase of more than 100 points creates a presumption that the merger is likely to create or enhance market power or facilitate its exercise.

Once the post-merger HHI and any differential are calculated, the current Guidelines then focus on what particular competitive harm, if any, is posed by the merger. The agencies will consider whether the merger makes it easier for firms to engage in coordinated interaction, which need not be unlawful standing alone, either through facilitating agreement on terms of coordination or making it easier to detect and punish deviations. Central to the analysis will be the availability of market information; market, firm, and product characteristics; past evidence of collusion; or whether the merger eliminates a firm that undermines coordination ("a maverick firm"). The agencies also will consider whether the merger makes it easier for a single firm to engage in unilateral anti-competitive behavior, such as by increasing prices or decreasing output depending on product substitutability and differentiation. Special scrutiny is given where the combined market share of the merging firms exceeds thirty-five percent and where the firms' products are close competitors.

At this stage, the focus of the inquiry shifts to consideration of various factors that might mitigate the anti-competitive effects of a particular merger. Sections 3-5 of the Guidelines contemplate three factors: post-merger market entry; efficiency; and the so-called "failing company" defense. With respect to market entry, the Guidelines hypothesize that a merger is unlikely to raise competitive concerns where a hypothetical entrant could easily enter the market, thereby counteracting any incentive to raise prices. To measure

the ease of market entry, the Guidelines ask whether such entry would be *timely* (i.e., generally two years from initial planning to significant market impact), *likely* (i.e., an entrant could generate annual sales at a level necessary to be profitable at premerger prices); and *sufficient* (i.e., generally that an entrant could obtain the necessary assets to capitalize on sales opportunities).

A rather recent statement, issued by the agencies in April 1997, articulates their revised official position concerning the efficiency benefits of mergers.¹³ Under the April 1997 statement, the agencies acknowledge the potential efficiency gains that otherwise could not be achieved absent a merger. However, the statement offers two central caveats with respect to any claimed efficiency gains. First, the Guidelines impose a rather strict causation requirement; namely, the agencies insist that they will consider only those efficiencies likely to be accomplished through the proposed merger and unlikely to be accomplished absent the merger or other anti-competitive means. Second, the Guidelines approach skeptically unsubstantiated efficiency claims and demand that merging firms sufficiently document the promised efficiency gains so that they can verify the likelihood, magnitude, means, and timing of any such gains. Thus, easily verifiable efficiency gains such as shifts in production facilities are more likely to be credited than others such as research and development benefits.

The final factor under the Guidelines is whether the merger is necessary to save a failing company. The rationale behind this factor is that the market is better off with the preservation of a failing company's assets through a merger than with the assets' loss if the firm exits the market. Accordingly, the nub here is the meaning of a failing company, which the agencies define as a firm (a) unable to meet its financial obligations in the near future, (b) unable to reorganize under the bankruptcy laws, (c) which has made unsuccessful good-faith efforts to elicit reasonable, less competitively threatening offers, and (d) whose assets, absent the acquisition, would exit the market. Similar principles may justify a merger with a firm's failing division where it is generating negative cash flows, where its assets otherwise would exit the market, and where competitively preferable alternatives are unavailable.

Separate guidelines of the Department of Justice, namely, the Non-Horizontal Merger Guidelines, govern what the agencies characterize as non-horizontal mergers (or more commonly referred to as vertical or conglomerate mergers). The government's review of these mergers employs many of the same concepts used in horizontal merger analysis (such as a consideration of market share, market concentration measured by the HHI, and standards for judging relevant efficiencies)

but also involves additional standards. With respect to vertical mergers, the Guidelines provide that a merger is more likely to be challenged in highly concentrated markets (HHI exceeding 1800) where it erects entry barriers (looking at the nexus between the primary and secondary markets, the requirements of entry, and the difficulty of entry), where it facilitates collusion or where it involves the elimination of a buyer whose behavior frustrates collusion among a particular level of firms ("the disruptive buyer"). With respect to conglomerate mergers, the Guidelines provide that a merger is more likely to be challenged in highly concentrated markets (HHI exceeding 1800) where a merger eliminates potential entrants whose presence or perceived presence on the edge of the market facilitates competition, where entry is difficult, where other outside firms lack similar entry advantages, and where the acquired firm has a high market share (at least five percent, with a high likelihood of challenge to mergers involving firms with more than twenty percent market share).

III. Procedure

As I noted above, a distinct question from the standards governing the legality of a merger is whether the merger is subject to notification and reporting requirements. Allow me briefly to review these standards and the procedures involved in seeking approval.

A. Preclearance under the Hart-Scott-Rodino Act

The Hart-Scott-Rodino Act contains detailed provisions governing whether a merger is subject to notification and a waiting period. To trigger the notice and waiting period requirements, the transaction must satisfy a basic three-part test. First, it must satisfy a jurisdictional requirement; namely, that either the acquiring or acquired entity be engaged in commerce or any activity affecting commerce. Under the broad "effects" test applied by the federal courts, this requirement usually is easily satisfied.¹⁴ Second, the entities involved in the transaction must satisfy one of several asset/annual sales requirements. Generally speaking, if either the acquiring or acquired entity has at least \$10 million in total assets or net sales and the other entity has at least \$100 million in total assets or net sales, the second requirement is met. Third, the acquisition itself must satisfy one of two size thresholds: as a result of the acquisition, the acquiring entity must hold either at least fifteen percent of the acquired entity's voting securities or assets or aggregate securities and assets in the acquired entity exceeding \$15 million.¹⁵

If a proposed transaction does not satisfy each element of this three-element test, the notification and waiting periods do not apply. However, even if the transaction satisfies the test, the notification and waiting periods still may not apply if the transaction quali-

fies under one of several exemptions. These exemptions, embodied in Section 7A(c) of the Clayton Act and subject to expansion by FTC regulation,¹⁶ include, inter alia, acquisitions in the ordinary course of business, obligations not in the form of voting securities (e.g., bonds), certain transactions to or from governmental entities or requiring agency approval, acquisitions solely for investment purposes provided that the acquired securities do not exceed ten percent of the issuer's outstanding voting securities, and certain institutional purchases (e.g., by banks or insurance companies) pursuant to a reorganization plan or in the ordinary course of business.¹⁷

B. Agency Evaluation

If the transaction does trigger the Hart-Scott-Rodino Act's reporting requirements, a Premerger Notification Form must be filed with the Federal Trade Commission and the Department of Justice. The Form requires the parties to describe, inter alia, their identities, the nature of the transaction, the voting securities and/or assets to be acquired, firm and industry financial information, vendor relationships, and insurance information. A thirty-day waiting period (fifteen days in the case of cash tender offers) begins to run upon the filing of the completed notification form. During this period, agency staff will review the materials and make recommendations to their respective superiors. The Agencies may, however, terminate the waiting period prior to its usual expiration time, provided that notice is given in the Federal Register. If a proposed merger is approved within the thirty-day period, no further action is taken. The agencies may, however, require the submission of additional documentary material (more commonly known as the "Second Request") and may extend the waiting period for an additional twenty days (ten in the event of a cash tender offer) after the date of compliance with the second request. (Further extensions require agency application to a federal district court.)

After the necessary documentation has been provided, each agency makes a final decision whether to challenge the merger. If an agency wishes to do so, it may seek a preliminary injunction in federal district court. After this stage, the identity of the challenging agency makes a difference, for the Department of Justice only may litigate matters in court while the FTC has the power to initiate administrative proceedings as well. The case may be resolved by means of a consent decree with the Justice Department, subject to judicial approval, or a consent order with the FTC. Both types of orders are subject to publication and a period of public comment. Absent a settlement, if the case is litigated, a court may order divestiture, rescission, or damages. Administrative law judge decisions in FTC proceedings

are subject to Commission review and further review in a federal court of appeals.

IV. Developments

One could offer many observations about the future directions of merger control, both general and specific. For purposes of this brief presentation, however, I wish to highlight one recent development.

In October 1999, the Department of Justice and the Federal Trade Commission released draft guidelines governing joint ventures.¹⁸ These guidelines represent an important development in the agencies' effort to bring the "guidelines model" of merger regulation to bear on a popular type of business undertaking, other than mergers, that may raise competitive concerns. The guidelines bifurcate joint ventures between those that are per se invalid and those subject to a closer rule-of-reason analysis, which entails a more detailed inquiry into an agreement's business purpose, anti-competitive harm, and pro-competitive benefits. These draft guidelines employ many of the same concepts as the Horizontal Merger Guidelines such as market share, measures of market concentration, and consideration of efficiencies and entry barriers. In other respects, however, the guidelines import additional methodologies. Let me provide just a few examples. First, the draft joint venture guidelines reflect the fact that joint ventures may have different effects on competition and entry barriers than mergers. Unlike a merger, which extinguishes at least one of the participants, joint ventures continue to allow the possibility of competition between contributors to the venture and the venture itself. Second, where pre-clearance is not required, the guidelines permit the agencies to look to the actual effects of an existing joint venture when considering its effect on competition. Third, the guidelines lay out a set of factors that the agencies will consider, beyond those elaborated in the Horizontal Merger Guidelines, when evaluating the significance of market share. These factors include exclusivity, control over assets, financial interests in collaboration, control of competitively significant decision making, the likelihood of anticompetitive information sharing, and the duration of the agreement. Fourth, they identify various "safe-harbors" in case of certain R & D ventures or where the market share of the collaboration and participants is under twenty percent. Finally, it should be noted that the joint venture guidelines contain a set of criteria defining when the agencies will consider a venture to be the equivalent of a horizontal merger: these include consideration of whether the participants are competitors, whether the formation involves efficiency-enhancing integration, whether integration eliminates all competition, and whether the collaboration does not terminate within a limited period (generally within ten years).

Endnotes

1. 15 U.S.C. § 1.
2. 50 U.S.C. App. § 2170.
3. 12 U.S.C. § 1828(c).
4. 12 U.S.C. §§ 1842-43.
5. 15 U.S.C. §§ 1801-04.
6. See *California v. ARC America Corp.*, 490 U.S. 93 (1989).
7. 15 U.S.C. § 15c.
8. See generally II Rowley & Baker, *International Mergers: The Antitrust Process* 1622.
9. 415 U.S. 486 (1974).
10. 370 U.S. 294 (1962).
11. United States Department of Justice and Federal Trade Commission, *1992 Horizontal Merger Guidelines* § 0.1.
12. See Sullivan & Harrison, *Understanding Antitrust and its Economic Implications* 386-387 (1998).
13. See United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* Section 4 (rev.) (Issued 8 April 1997).
14. See, e.g., *Hartford Fire Insurance Co. v. California*, 509 U.S. 764 (1993); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).
15. See 15 U.S.C. § 18(a). See generally 3 Spires, *Doing Business in the United States* § 37.03 (1999).
16. 15 U.S.C. § 18a(d)(2)(b).
17. 15 U.S.C. § 18a(c).
18. See generally Federal Trade Commission and United States Department of Justice, *Antitrust Guidelines for Collaborations Among Competitors* (Draft issued 1 October 1999).

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Investment in Romania: Some Points of Interest

By Christine E. Moore and Patricia M. Petersen

I. Some General Corporate Issues

My practice is exclusively the representation of foreign investors in Romania. The investments fall into several general categories:

- Greenfield investments.
- Joint ventures with private Romanian companies.
- Joint ventures with Romanian State companies.
- Acquisitions through the privatization process.
- Venture capital investment in private Romanian companies.

In many of these cases, one of the steps involved is the formation of a Romanian legal entity. This routine process is often the investor's first encounter with the legal framework in Romania: The investor's willingness to adapt to the process, which is very different from what they are used to, varies widely from one investor to the next. Company formation is slow and cumbersome, with large numbers of detailed documents being required, many of which seem to have no reasonable use. The resulting company has a much less flexible structure than is the case in more developed economies, with a much larger dependence on the general meeting of shareholders for management decisionmaking.

Thus venture capital investors, who typically do not form Romanian entities, run into problems due to the inflexibility built into the Romanian Company Law. For example, many structures commonly used in structuring minority shareholdings and providing an exit strategy for a venture capital investor are difficult to implement under Romanian law. At the root of these problems are two underlying principles of Romanian law. First is the unavailability of specific performance as a remedy in contract enforcement and the second is a provision in the Company Law providing that agreements by shareholders as to the manner of voting their shares are null and void. Thus any corporate actions that require shareholder approval (and there are many of them) cannot be guaranteed by contract, nor can the exercise of share options, piggyback rights and similar mechanisms. Often off-shore agreements can be used in order to give effect to the desired structure.

One example is the case of a strategic investor who acquired a minority interest in a Romanian company and wished to implement a call option to acquire a majority interest over a period of time under certain conditions. An off-shore agreement was used, secured by a pledge of the shares in the Romanian company. In

this way, breach by the individual shareholders of their obligation to sell their shares pursuant to the option would result in the strategic investor being able to execute on the pledge and force the sale of shares.

Investors need to be flexible enough to find creative methods to implement the desired commercial agreement.

II. Privatization

Privatization has proceeded fairly slowly in Romania since the revolution, due in part to a series of privatization laws, which were extremely bureaucratic and inflexible, combined with unrealistic prices set by the State. It is hoped that the new Privatization Law, which became effective on 27 May 1999, will alleviate many of these problems. In summary, the following changes have been implemented.

A. Establishment of the Selling Price

1. Old Law

Under the previous legislative framework, the concept was established that the shares of a company undergoing privatization would be sold for their market value. However, instead of relying on the market to determine this market price, primarily through the normal offer/demand negotiation process, the seller would prepare a "valuation report" for the company shares and, on this basis, establish an opening offer price for the purchase of the shares. Unfortunately, this offer price did not take into account the actual situation at many of the state-owned companies offered for privatization, nor did such price account for the real debt levels existing at such companies.

Although this approach was a reasonable basis for beginning the process, in fact and in practice this approach became a political and psychological obstacle to privatization for several reasons. First, because the valuations inevitably resulted in a selling offer price far in excess of any reasonable market value, buyers would submit offers far lower than the selling offer price. The seller, having convinced itself that its offer price established by the valuation was the "true" market value, often rejected buyer's offers and/or canceled the privatization tender on the basis that the offers were unreasonable, only to repeat this process again in the future for the same company.

Second, by publicizing a selling offer price based upon an inflated valuation report, certain political expectations were created that the subject company's shares were in fact worth the amount publicized. In the

event that the seller would sell the shares for a price significantly below the publicized price, it would be a target of criticism and ultimately the political cost of such a course of action was unacceptably high.

2. New Law

The 1999 Privatization Law implicitly recognizes that valuation reports, which are prepared in accordance with Romanian (versus internationally accepted) accounting standards, often inflate the values of companies. For example, many Romanian companies, insolvent by international standards, appear on paper to be profitable companies by Romanian accounting standards.

Under the new law, the concept of the valuation report as a basis for establishing an opening selling price has been eliminated. Although the seller may still prepare valuation reports, these are intended under the new law to act simply as a tool in the negotiation process, primarily in establishing investment levels required at the company in order to turn the company around.

The new law also sets forth the principle that the nominal value of the respective company's shares will be the opening selling price. Although the nominal value of the shares may also be an unrealistic market value, it is generally accepted that this value is indeed much closer to the market conditions. In any event, the final selling price is subject to negotiation between the seller and the buyer.

Most importantly, the opening price is no longer considered to be determinative in canceling the tender offer; ultimately, the sales of shares are now to be dictated on a "best offer" basis.

B. Payment in Installments

1. Old Law

The ability to make installment payments of the purchase price for shares purchased from the State Ownership Fund was strictly limited to domestic buyers qualified as small and medium-sized companies and employee associations. In many cases, this created obstacles to privatization.

2. New Law

Under the 1999 Privatization Law, any buyer, regardless of nationality or size, may request the right to pay the purchase price in installments. This is a matter of negotiation between the buyer and the seller, the law making clear that this facility should be granted to the buyer in the event that this represents a "deal breaker."

C. The Presentation File

1. Old Law

The former legislation required the seller to prepare a presentation file for each company offered for privatization. This file was to contain information about the company and was prepared and presented in accordance with a standard format. Unfortunately, this standard format was unable to account for the unique qualities of a particular company and the specific issues relevant to that company's industry or service sector.

More importantly, this presentation file was created at a single point in time and not updated throughout the privatization process. As a result, information quickly became outdated and buyers were left without sufficient information upon which to make an informed decision.

Finally, even where buyers sought to educate themselves about the relevant company through a due diligence investigation, access to the companies and relevant documentation was often impeded by the seller and/or the Company's representatives, especially in cases where there was resistance to the privatization.

As a result of this lack of information, many buyers simply would not bid on companies offered for privatization or would not be able to conclude transactions with the seller, due to concerns about unknown liabilities.

2. New Law

The 1999 Privatization Law provides that potential buyers will be presented with a presentation file that contains significant information about the subject company and, more importantly, the seller is obligated to update this presentation file throughout the privatization process, both as a matter of regular practice and in any other circumstance as warranted by changes at the company that may have an effect on the privatization transaction.

Additionally, the new law expressly acknowledges the rights of potential buyers to conduct due diligence reviews of companies and establishes access to company documents and company management as a part of this process.

D. Indemnification of Buyer

1. Old Law

Although the former law was silent with regard to indemnification of the buyer, the accompanying methodological norms provided a liability shield for the seller and immunity from suit by injured parties who

suffered damages because of the company whose shares were sold or because of an asset that was sold. This immunity from suit, together with the power of the Court of Accounts to audit and penalize the seller for certain actions deemed to be against the state interest, resulted in a situation where the seller consistently refused to indemnify the buyer against unknown or undisclosed liabilities.

Together with the insufficient information given to the buyers through the presentation files and the lack of full access to conduct due diligence, buyers understandably were hesitant to take significant equity positions in Romanian companies.

2. New Law

The 1999 Privatization Law specifically provides that the seller may indemnify the buyer against certain damages arising from undisclosed liabilities existing at the time of purchase. The law limits this liability to the value of the purchase price paid by the buyer.

In addition, the buyer may obtain a state guarantee as to tax and other state budget liabilities. In essence, this is offered on the basis of a fiscal audit, which specifies any and all budgetary liabilities of the company at a fixed point and time.

E. Environmental Liabilities

1. Old Law

Under the former law, any sale of shares whereby the state would transfer a majority equity position in the company required the seller to prepare an environmental report for the company. This report basically set forth the company's status vis-à-vis existing environmental legislation and included the steps required to bringing the company into environmental compliance.

The obstacles to privatization created by the need for the environmental report were both procedural and substantive. Procedurally, the time required to carry out the environmental audit and prepare the report was extensive, thus causing delays in moving the privatization forward.

Substantively, the preparation of the report did not trigger any liability on the part of the seller or the environmental authorities that issued the report for its accuracy or completeness. Standing alone, this was not necessarily a problem. But, together with the legal requirement that the environmental obligations identified in the report be included as direct buyer obligations in the sale-purchase agreement to be concluded between the seller and buyer for the company shares, the end result was that the buyer (not the company) would be taking upon itself direct obligations to reme-

dy certain environmental deficiencies without comfort that such remedial action was sufficient, complete, or even necessary to bring the company into environmental compliance with Romanian law.

2. New Law

In order to overcome the procedural obstacles identified above, the 1999 Privatization Law provides that all companies in which the state holds the control are obligated to initiate the preparation of the environmental report as of the date the new law comes into force. Moreover, the competent environmental authority is obliged to endorse the report within a prescribed time period. Failure to so endorse within the specified time results in deemed compliance by the company with the applicable legislation and no imposed compliance obligations other than the obligation to obtain a new environmental authorization within two years of the privatization.

The new law also provides that fulfillment of the environmental obligations contained in the endorsed environmental report are obligations of the company, not of the buyer of the shares. The sale-purchase contract to be negotiated between the seller and buyer will not, therefore, create direct obligations of the buyer to take remedial actions, but rather will include a commitment to direct investments for this purpose.

Finally, the new law introduces the ability of the seller to indemnify the buyer or the company for damages arising from undisclosed environmental liabilities existing at the time of the privatization.

F. Real Estate in the Registered Social Capital of the Company

1. Old Law

Although the constitutional and legal principles of real estate ownership by Romanian persons have been in place for many years, many state-owned companies still lack proper and full legal title to their real estate assets in registered form, due primarily to administrative blockage. Although the process of issuing such title is an ongoing one, until a state-owned company has the proper documentation, such title is often not included in the company's registered capital. As the title is issued, the company includes the value of the real estate asset in the company's registered capital and issues shares to the State Ownership Fund as consideration for the contribution to capital.

The problem created by this in the privatization context is that, when such shares are issued to the State Ownership Fund in consideration for the capital contribution, this results in a dilution of the remaining shareholders. In cases where a privatization involves the sale

of a slim majority to an investor, this dilution could result in the investor acquiring a majority position at the time of privatization, but then losing this majority position through dilution.

2. New Law

The new law sets forth specific protections to the shareholders in situations such as that described above by giving such shareholders certain rights that will protect against dilution.

G. Property Restitution

1. Old Law

The prior legal regime regarding property restitution and the effect of restitution claims on commercial entities was unclear and incomplete. In essence, buyers of company shares received no specific protections in the event that the company's assets would specifically be the subject of such claims (versus monetary damages).

2. New Law

Under the 1999 Privatization Law, specific protection is given to companies where the subject of the restitution claim is an integral element of the company's operations. In these cases, the state will pay compensation in the form of monetary damages to the former owner instead of returning the subject real estate asset, thus protecting the company from loss of integral real estate assets. The new law also contemplates state reimbursement to companies that suffer damages resulting from the adjudication of certain restitution claims.

H. Privatization Agents

1. Old Law

Under the former legislative framework, the seller of the shares of companies to be privatized was the State Ownership Fund and it was given full responsibility for the privatization process. For certain significant privatization transactions, the State Ownership Fund would, from time to time, retain the services of outside advisors to assist it in the transaction. Nevertheless, for a variety of reasons, the State Ownership Fund has been unable to carry out these responsibilities as originally envisioned.

2. New Law

The 1999 Privatization Law, recognizing the limitations of the State Ownership Fund to move the privatization process forward, introduces the possibility of using privatization agents or consortia of privatization agents to manage certain privatization transactions—primarily those involving large state-owned companies and pools of companies.

These privatization agents are granted a broad range of responsibility and authority in acting on behalf of the State Ownership Fund (as seller) in the sale of shares of companies slated for privatization. It is intended that, by "privatizing" the privatization process, market forces will come into play and this will result in a more efficient, timely, and effective privatization process in Romania.

I. Debt Restructuring

1. Old Law

At present, the Romanian economy is faced with an enormous economic blockage created by circular obligations involving chains of state-owned companies. In most cases, the state is simultaneously a direct creditor of the state-owned company (e.g., for unpaid taxes and other state debts), a majority shareholder in the state-owned company, and a majority shareholder in the state-owned company's other creditors. To enforce collection by one entity of the debts owed to it could set off a chain reaction of insolvency and bankruptcy throughout the system.

Moreover, to allow the large state-owned creditors (such as the utility providers) of state-owned companies to convert their debt into equity would distort further the equity structures of these companies and create additional obstacles to privatization.

Because of the limited ability to obtain debt restructuring or forgiveness, this blockage creates a significant impediment to moving the privatization process forward.

2. New Law

The new law creates the opportunity for certain specified debts to be restructured or forgiven for the purposes of encouraging privatization.

J. Involvement of Ministries

1. Old Law

Under the former law, the State Ownership Fund was exclusively empowered as the seller of the state's shares of state-owned companies. In certain cases, however, the privatization process required the involvement of the responsible ministry overseeing the company's operations, primarily with regard to regulatory issues. Involvement of such ministries in the process was a politically sensitive and bureaucratically difficult process, resulting in a blockage of the process.

2. New Law

Under the new law, the ministries are brought into the privatization process in cases where the company to be privatized is subject to industry-specific regulatory requirements. This explicit inclusion will enable

investors to negotiate simultaneously the purchase of shares and regulatory/operational issues of concern.

K. Expanded Concept of Privatization

1. Old Law

Under the old framework, privatization as a concept was focused on the sale of shares owned by the state in state-owned companies. The State Ownership Fund, as seller, devoted its efforts in this regard.

The former concept generally overlooked, however, other means and methods of moving state assets and activities into the private sector.

2. New Law

The 1999 Privatization Law expands the concept of privatization to include various acts that would result in an overall transfer of state-owned or state-controlled assets into the private sector. The law expressly provides for sales of properties and assets of state-owned companies and regie autonome, as well as streamlined liquidations of certain companies and obligatory sales of such companies' assets.

In general, the new law has as its overall intention an acceleration of the process of moving state assets and control into the private sector. To support this intention, other existing laws have also been changed where changes were deemed necessary to support the acceleration of the privatization process.

III. Conclusion

The key to successful investment implementation in Romania is flexibility. Investors must assume the higher level of risk associated with the stage of development of the business and legal environment and have the ability to seek creative transaction structures that accommodate the legal limitations of the system while implementing the commercial deal and minimizing the risk to the fullest extent possible.

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Privatization in Eastern and Central Europe

By John White

I. Introduction

A. What is Privatization?

Due to its potentially broad scope, privatization can perhaps best be defined in simple terms as the transfer by the state of state-owned property to the private sector. Although the transfer of state-owned enterprises (“SOEs”) is one of the most common examples of privatization, governments can also privatize business units, land, housing and even the provision of services. Further, privatization occurs in many different forms, due in part to the fact that it must exist within the broader economic and political forces of its host country, government, city, industry or business.

B. Forms of Privatization

Privatization programs have employed a wide range of techniques and options. Without attempting to cover all possible permutations, below are listed some of the basic approaches to privatization.

Public Offerings: (The public offering of sales of shares in the SOE.) The voucher system is one variation of this method—used particularly in the Czech Republic and Russia (but also in other countries)—pursuant to which the public was granted vouchers to purchase the shares. Vouchers used as a form of “currency” for the purchase of services on the open market is another form of privatization.

Private Tender: The private sales of shares in the SOE by way of tender or public auction. Tenders may also be held in respect of a business unit or for the provision of services by private business.

Management and/or Employee Buy-Outs: A new firm is created by employees pooling their resources and borrowing new funds. This new firm then buys the existing SOE, thereby making it privately owned.

Incorporating New Private Investment into an SOE: The new investment can be undertaken either through a public sale of shares or through private placements.

Liquidation: The selling off of SOE assets by liquidating the company and thereby wiping out its outstanding debts. The assets are then repackaged for sale to investors at a lower price than their value prior to liquidation.

Fragmentation: The SOE is restructured into its component parts and sold separately. The profitable parts of the company are sold as separate firms.

Corporatization: SOEs are reorganized along business lines. Typically they are required to pay taxes, raise capital on the market and operate according to commercial principles.

Public-Private Competition: Public services are opened up to competition with the private sector. In-house public organizations are allowed to participate in the bidding process.

Outsourcing: The government competitively contracts with a private organization, for-profit or non-profit, to provide a service or part of a service.

Commercialization: The government stops providing a service and lets the private sector assume the function.

Franchise: A private firm is given the exclusive right to provide certain services (sometimes limited to a geographical area).

Management Contracts: The operation of a facility is contracted out to a private company. Facilities where management is frequently contracted out include airports, wastewater plants, arenas and convention centers.

Asset Sale or Long-Term Lease: A government sells or enters into long-term leases with private firms for assets such as airports, gas utilities or real estate. In a sale-leaseback arrangement, the government sells the asset to a private sector entity and then leases it back.

Private Infrastructure Development and Operation: The private sector builds, finances and operates public infrastructures such as roads and airports, recovering costs through user charges. Several different techniques are used, including Build-Operate-Transfer (“BOT”) arrangements, where the private sector designs, finances, builds, and operates the facility over the life of the contract. At the end of this period, ownership reverts to the government. A variation of this is the Build-Transfer-Operate (“BTO”) model, under which title transfers to the government at the time construction is completed. Finally, with Build-Own-Operate (“BOO”) arrangements, the private sector retains permanent ownership and operates the facility on contract.

C. Background of SOEs and the State-Led Approach

State-led strategies for economic growth were popular in the 1950s, 1960s, and 1970s, when it was argued that the public sector was better suited than the private

sector to foster and manage the industries most essential for economic growth. In addition, SOEs were seen as a way to create jobs, enhance regional development and prevent control of the economy by foreign firms. At first, governments became the owners of industrial and service enterprises in key sectors, such as steel, telecommunications, fertilizers, automobiles, petrochemicals, hotels, airlines and banking.

As state-led approaches became more common, the functions assumed by government grew as well, until, in many countries, SOEs practically dominated economic activity.

By and large, the current trend in economic analysis is that SOEs and industries with substantial government ownership are less efficient than privately held commercial entities. Advocates of privatization argue the following adverse consequences of government ownership of business to support their cause.

- *Lack of Competition:* In most cases, SOEs are protected from competition through government regulations that grant them monopoly power in key sectors. Protection is also achieved through high tariff barriers or other measures designed to restrict or eliminate foreign competition. The result is monopoly pricing and little or no funding for research and development to improve efficiencies or services. Another related problem usually is over employment and low productivity.
- *Government Subsidization:* The above factors inevitably required government subsidization to permit SOEs to charge prices below cost-of-production levels for such items as electricity, gasoline, or other goods and services. This indirect government aid led to large public-sector deficits and foreign-debt burdens. Most typically, governments in these circumstances borrow heavily or print money to cover these costs, which leads to high inflation, the discouragement of further investment and resultant capital flight.
- *Non-Competitive Industrial Base:* The overall result is that state-owned industrial enterprises simply cannot compete in the international marketplace.

These factors lead the stronger proponents of privatization to argue that where incentives to innovate or to reduce costs are important, there is little capacity for state ownership.

As a consequence, and in very broad terms, the basic aim of privatization is to free up the resources of the state from the inherent cost of controlling industry

and to create or stimulate competitive market forces—with the hope for increases in efficiencies and service quality.

D. Privatization—The Measures of Success

Judged by the number and scale of transactions, privatization has been a success. In 1997 proceeds from selling state-owned enterprises worldwide hit a record \$162 billion. France, Italy and Spain all launched huge, popular and very successful public share issue privatizations. Telecom Italia's \$15 billion offering in November 1997 was the largest in European history, surpassing Deutsche Telekom's IPO from the year before. France Telecom and the multiple Spanish offerings from Telefonica and Argentaria likewise transformed share ownership patterns in their countries.

However, for privatization to deliver, consumers need to benefit from lower prices, better service or new products. Workers need higher wages and better jobs in return for greater productivity. Other employees, who lose their jobs as a result of restructuring, need severance benefits. The new owners need to make money. Sellers—the governments—need to receive the highest prices in open bidding to make sure that taxpayers get a fair deal and to avoid accusations of “giving away the family silver for nothing.” In addition, any analysis must look at the costs and benefits over a very long period of time—not just one or two years.

E. The Benefits of Privatization

Some recent research conducted by the World Bank studied performance changes for a combined sample of two hundred eleven companies, from fifty industries over a period of more than twenty years. Their results report substantial increases in sales, profitability, capital investments and operating efficiency in the privatized companies and industries. There was even a slight increase, on average, in the number of employees after privatization. The companies in question come in almost equal numbers from developing and from industrialized countries.

Researchers at New York University studied one hundred twenty-eight privatized firms and ninety SOEs in the Czech Republic, Hungary and Poland. They found immediate increases in revenues and productivity following privatization. These researchers concluded that firms sold to foreign owners laid off fewer workers compared with SOEs in their sample.

Empirical evidence aside, privatization is generally thought to provide the following benefits:

- *Investment Capital:* Privatization brings new capital from the sale of shares and/or from invest-

ments made by the new owners, particularly when the new owners are foreign investors.

- *Cost Reductions/Improved Efficiency:* The increase in efficiency contributes to cost reductions and improved profits.
- *New Management:* Managers of privatized firms are generally able to act in a more commercial manner, relatively free of the political constraints of government. It is also generally perceived that private firms operate with greater flexibility, allowing them to adjust more rapidly to changing market conditions.
- *Technology and Training:* New investment and new management will usually carry with them an injection of new technologies. Greater efficiencies should also result, freeing up capital for investment in technology and training.
- *Greater Competition:* The entry of private firms forces competitors to produce their products and services more efficiently, lowering costs for their customers.
- *Fiscal Stability:* Expenditures incurred in subsidizing SOE operations and covering their losses reduce as the SOEs are privatized. Lower government expenditures should, in turn, reduce the inflationary pressures.
- *Capital Market Development:* The symbiotic relationship between privatization and the capital market stimulates or even creates the need for this development.
- *Social Programs:* The sale of SOEs enables governments to employ the resources previously consumed in keeping them afloat for other purposes.
- *Attracting Foreign Investment:* A stable macroeconomic environment, in turn, is a key aspect of attracting foreign investment, which may bring many important benefits for recipient countries, including technology transfer, job creation, and export development.
- *Benefits for Foreign Investors:* Privatization offers important potential benefits for foreign investors, and many countries have designed their privatization programs to maximize foreign participation.
- *New Markets:* Privatization provides foreign investors the opportunity to penetrate new markets in developing countries and regions. The long-term growth and earnings potential in many of these markets is higher than in the mature,

highly saturated markets of the industrialized countries. The acquisition of SOEs can also help foreign investors establish operations more quickly than a “greenfield” investment.

- *Lower Entry Barriers:* The acquisition of an SOE may be preferable in capital-intensive industries that have high start-up costs and entry barriers.

F. Another View of Privatization

There have always been skeptics and opponents to privatization: by its nature it is politically sensitive. Some recent studies have attempted to re-examine the facts and figures cited in support of privatization. Others have attempted to determine exactly what elements of privatization bring about the beneficial results.

For example, one academic has noted that the efficiency of privatized businesses improved in most cases when the privatization occurs contemporaneously with deregulation or other types of competition-enhancing measures. That study concluded that it is the level of competition and not ownership per se that best determines efficiency and gains.

Another charge against privatization is that the benefits are not equitably distributed or that they are squandered during the process. There is no doubt some truth to these assessments.

However, the World Bank, for example, has taken a more pragmatic view of this situation—recognizing that privatization is always, inevitably and intensely, a political process. Accordingly, some people are always likely to suffer in the immediate aftermath of a privatization program.

II. A Brief Survey of Privatizations

Based on the collective experience of those involved, this paper will briefly review the privatization process in Poland, Czech Republic and Hungary.

A. Privatization in Poland

1. Background

Ten years into Poland’s transition into a market economy, privatization seems to have made substantial headway. According to various researchers, privatization is almost complete in some sectors, such as consumer goods and services, while in others, such as banking, it is fairly advanced. However, in some (especially the large) politically sensitive sectors such as public utilities and some portions of heavy industry, it has barely started. Nevertheless, in the current climate, the proponents of privatization claim that there is strong political support to accelerate the overall process due to the fact that privatization revenues have become crucial for implementing the reform of other social programs.

One of the interesting features of the Polish privatization experience has been the adoption of appropriate legal regulations requiring relatively high-quality disclosure standards for privatized companies. According to some observers, these have made the country's capital market much more transparent than in other Central European countries and have ensured a relatively healthy and largely privatized banking sector.

Another notable aspect of the Polish experience was that "top-down" privatization was not the primary factor in creating the new ownership structure of the current economy. Even more important was the explosion of newly funded private firms, which have become the driving force in Poland's economic growth. At the same time, economists note that the systematic contraction of the public sector through liquidations, bankruptcies, asset downsizing and privatization has helped create the conditions allowing the new entrants to prosper.

2. Privatization Timetable

In May 1998, the government introduced an ambitious privatization timetable through the year 2001 calling for the sale of all enterprises and sectors still under state ownership, including infrastructure sectors. The plan calls for completing privatization for most sectors and starting on the remaining ones by the year 2002.

Parallel to this program, the government started preparations to privatize the country's telecoms system and large banks. These companies and banks were partly privatized in 1998, greatly augmenting the government's budget.

3. The Scope of Polish Privatization—Facts and Figures

From the start of the privatization process in late 1990 until the end of 1998, and excluding rural enterprises privatized under special programs, the number of enterprises participating in the privatization process as of the end of 1998 totaled 4,475, representing a fifty-three-percent participation rate. The number of enterprises completely privatized came to 2,454 (twenty-nine percent), while those partially privatized, including those under the voucher program, was 2,021 (23.9%).

The number of state-owned enterprises as at the end of 1998 was 2,906, of which 1,818 conducted full economic activity. In addition, as of December 1997, the authorities had completed bankruptcy procedures for 278 state enterprises and implemented 203 bank conciliation procedures; debt-equity swaps were adopted for 135 companies in the latter group.

4. The Form of Privatization

Different methods of privatization adopted in Poland created different types of wholly or partially

privatized enterprises. Various researchers note that the traditional methods of privatization, such as sales to strategic investors (especially foreign investors) or public share offerings, proved to be the most successful in terms of completed privatization, reliable corporate governance and good economic performance. Management and/or employee buy-outs were a second-best, but were also quite efficient, at least for the first stage of privatization.

In comparison, the same researchers point out that the outcome of voucher privatization has been rather discouraging. They claim that the performance of the enterprises following this privatization track have systematically worsened. They also note that commercialized companies still under state ownership have not performed well and are in critical need of restructuring. They claim that inefficient corporate governance is a major factor in the weak performance of both these enterprise categories.

Researchers have quantified the forms of privatization used in Poland as follows:

- *Commercialization*: Being the preliminary stage before privatization, commercialization was introduced in 1,343 large companies. Of this group, 240 large companies have been entirely privatized via capitalization (through IPOs, public tenders or negotiations following public invitations).
- *Vouchers*: Some 512 commercialized companies were designated for the voucher program. Their shares have been transferred to fifteen National Investment Funds, and these share certificates were distributed to the public in 1995-96. About 25.7 million Poles, or ninety-six percent of the adult population, have acquired them.
- *Sales of assets*: This method was used predominantly for medium or small enterprises. The number of operations following this privatization track from 1990 to December 1998 came to 1,551. Among them, 1,515 completed the process, of which 1,021 enterprises were leased to management buy-outs, 312 were sold for cash, 127 were contributed in kind to new companies, and the remaining were privatized using mixed methods. Direct sale of assets has been the most popular privatization procedure utilized in Poland and by far the quickest to implement.
- *Liquidation*: Around 1,581 state enterprises in weak financial condition have been involved in the liquidation privatization program under the state enterprise law. As of December 1998, 699 of them have been liquidated via sale of their assets to outside private owners for cash; less frequently, the assets have been transferred to the employ-

ees. A large group (some two thousand) of state-owned enterprises, approximately one-quarter of those at the starting point, were not included in the process. This group consisted mainly of small and medium-sized enterprises that were in worse economic condition than the privatized ones, but also includes more than four hundred large state companies. Among them are the fifty largest Polish enterprises belonging to the public sector.

5. Relative Performance

In attempting to judge the relative performances of Polish privatized enterprises to their state counterparts, certain researchers have observed striking differences in investment behavior between privatized and non-privatized operations. They claim that in the past few years privatized enterprises in Poland have reinvested ten to thirty percent of their sales annually, while the broad group of state-owned or quasi-state-owned enterprises invested only one to three percent of their sales. They also point out that, on the macro level, the investment rate of the private sector over the past decade has been much higher than in the public sector.

B. Privatization in the Czech Republic

Privatization began quite ambitiously in 1991, when a multi-track approach was chosen to divest thousands of small and larger firms. Most of the over twenty thousand small businesses sold were sold in public auctions, which gave Czech entrepreneurs a chance to buy shops and small firms. A sub-set of keenly sought after companies was given case-by-case consideration, which typically resulted in tenders or negotiated sales.

The government also initiated a restitution program, which returned thousands of businesses, apartment blocks, small factories and real estate properties to their pre-communist owners.

The first wave of voucher privatization was conducted in five rounds. In each round, bidders used their voucher points to bid for the available shares of privatizing firms. Share prices were set by the Ministry of Privatization and adjusted in subsequent rounds based on the demand for shares at the original price. Thus, for shares where demand exceeded supply, the prices were raised prior to the next round, while the prices of shares with excess supply were lowered. Unused voucher points were returned to the bidders for use in subsequent rounds. The price adjustment mechanism established in each round ensured that the valuation of corporate shares was achieved through a market-based, supply and demand mechanism.

The voucher system was also responsible for the growth of the Investment Privatization Funds (“IPFs”),

which operated with vouchers collected from citizens who preferred to let the IPFs invest their vouchers in available companies. IPFs were structured as joint-stock companies, with citizens who assigned their vouchers to an IPF being stockholders.

However, the consensus view among critics is that the voucher program has not been as successful in the Czech Republic as was hoped. The main criticism is that sophisticated capital markets will not begin to function until the IPFs deal in shares instead of vouchers. Moreover, it would seem that there were relatively few safeguards to protect small investors from unscrupulous IPF operators. Despite a proliferation of funds (more than four hundred), there was no agency to monitor their operation and few laws to protect the interests of minority shareholders. One common practice was that of “tunneling”—an extreme form of asset stripping leaving the original asset owner less than fairly compensated.

As the early privatization methods (including vouchers) slipped away, foreign direct investment began to play a more important role. The foreign direct investment (“FDI”) inflow received a strong impulse in 1995 when the dominant telecom firm was partially sold for US\$1.4 billion. After a drop in 1997, FDI reached a record US\$2.5 billion in 1998.

C. Privatization in Hungary

1. Background

By the time Hungary’s comprehensive privatization program started in the spring of 1990, Hungary had already moved away from a planned economic system and full state ownership. Commentators have reflected that previous reforms had promoted the emergence of small private businesses and that several market institutions, like a two-tier banking system, had been created prior to such privatization programs. Other helpful reforms included the introduction of securities laws, tax reform, policies enabling the formation of joint ventures with foreign partners, and a company law providing a general framework to fund shareholding companies. Another relevant event was that, in the late 1980s, the government sharply decreased subsidies to state enterprises, liberalized foreign trade and relaxed price and wage regulations.

As a consequence of the above reforms, management autonomy for state firms gradually increased. Another important step in the privatization process occurred in 1985, when most property rights shifted from the state to management via the creation of enterprise councils—thereby introducing corporate self-government. Such councils, established at two-thirds of economic units, consisted solely of insiders. These self-

governing bodies obtained the right to determine the enterprise's organizational structure, to appoint the chief executive, to decide on mergers, to split up into smaller organizations and to create joint ventures with foreign firms with the state assets under their control.

2. Form of Privatization

The bulk of state-owned assets in Hungary were disposed of by the state through sale or auction. Primarily, this consisted of auctions to local buyers in small-scale privatizations or by direct sales to local and foreign investors via public competition, public tender, private placement and public offerings on the stock exchange.

During 1995-96, the period known as the "big privatization," most gas and electricity suppliers, along with power plants and banks, were sold to strategic investors. Government ownership of each of the telecommunications, banking and the energy industry, has also reduced. Similarly, in the second half of the 1990s, companies within the pharmaceutical, chemical, oil industry and manufacturing sectors were listed on the stock exchange.

At this time, the government also introduced some restructuring packages for the less viable enterprises. These companies were restructured by the state and then sold under the privatization program. Corporate restructuring was also accomplished by the new owners after buying state company shares. In some cases, the new owners purchased these shares below their nominal value, but also became liable for the previous debts of the acquired entity or, in some cases, were required to introduce new capital into the acquired entity.

Interestingly, the precursor reforms to the "big privatization" period also served as the starting point for several unconventional forms of privatization in Hungary.

- *Spontaneous Privatization*: The first innovation, the so-called "spontaneous privatization" adopted between 1988 and the spring of 1990, was based on the self-governing units and the new company law. Several dozen large enterprises, all facing unenviable economic circumstances, divided themselves into groups of companies. Their aim was to segregate loss-making units, giving the more viable ones the opportunity to find new owners, to pursue new markets or to offer debt-equity swaps to banks and other creditors.
- *Free Distribution*: The most widespread method of this form of privatization was restitution. Compensation notes valued at around HF 220 billion were distributed to two million citizens who had

been deprived of their property or whose human rights had been violated during World War II and under socialism. The freely tradable compensation notes could be used in auctions for agricultural land, converted into shares of state firms listed on the stock exchange, or substituted for cash in purchasing privatized companies. The process of compensation is still underway.

- *Small Investor Share Program*: Similar to the Czech voucher system, under this program, all Hungarian citizens were offered the opportunity to acquire shares. The first phase, offering shares in only two companies, started just before the 1994 parliamentary elections. However, this initiative ceased upon a subsequent change in government.
- *"Existence Loans"*: This form of privatization aimed to sell state assets on preferential terms, of which the "existence loan" or E-loan was the most widespread. E-loans, which were long term credits with a five-year grace period and an interest rate well below the rate of inflation, could be used only for buying state assets from the government's privatization agency. E-loans contributed to employee and management buy-outs and played a role in more than four hundred transactions valued at HF 68 billion between 1990 and 1998.
- *Self-Privatization*: Under this program, initiated in 1991, the government identified nearly five hundred small and medium-sized companies for a special self-privatization project. In these companies, the State Property Agency reserved for itself only controlling functions, such as legal control, and delegated the rights and responsibilities of selling these state assets to private consulting firms. The consultants were offered a well-defined incentive scheme, with their compensation depending on the speed of privatization and price. As a result, most enterprises covered by the program were sold.

III. Privatization—Lessons from Experience?

There is, of course, no best way to privatize. However, numerous studies and reports on the many privatizations that have been undertaken worldwide do provide an important reference point or explanation as to why some attempts to privatize may be more successful than others. Listed below are some of the more often repeated views from the school of "hard-knocks" in privatization, this writer's included.

Full Governmental Backing: Privatization is necessarily a political business. The cooperation of many limbs of the government and its agencies will be required. For privatization to succeed, the most senior government officials will need to be involved and directly supportive. Such support will be critical if new laws are required to complete any privatization.

Legislate: Many countries try to sell companies or restructure industries before enacting the necessary enabling laws. This produces delays, scuttles deals and creates enormous uncertainty for investors.

Transparency: A truly transparent privatization process (especially in the case of tenders and auctions) is imperative for the economic and political success of privatization. A lack of transparency can result in political backlash and create an atmosphere of uncertainty for potential purchasers or investors.

Privatization as Part of a Broader Program: Privatization works best when it is part of a larger program of reforms promoting efficiency. Further, broader social programs, when initiated with specific privatizations, can help to mitigate the initial economic effects of privatization.

Privatize Privatization: Involve a full complement of quality advisers (including lawyers, bankers and technical advisers) at the outset. Typically, governments will need assistance to structure transactions. Further, without such assistance, the process can simply become too politicized.

Preparation Is Key: Privatization requires the coordinated efforts of government, governmental departments, industry, purchasers or investors and requires considerable preparation.

Corporate Governance: Good securities laws, corporate financial reporting and protection for minority shareholders are essential for privatization to succeed.

Timing: To be done properly, any privatization will take time. If rushed, more likely than not an important element to the success of the privatization will be missing. A transparent process (involving audits and due diligence) cannot be achieved overnight.

Don't Exclude Foreigners: Some of the most successful privatizations in Eastern Europe strongly encouraged foreign investors.

Outsiders Are Better than Insiders: Privatization's performance where the only buyers have been insiders (e.g., managers and workers) have generally not fared as well. Sometimes insiders are more interested in maintaining their jobs and less interested in restructuring the firm.

Don't Limit the Number of Bidders: Increasing the number of bidders should lead to a higher price and improve the chance for striking the best deal.

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Use Requirement in the Countries of the Former Yugoslavia

By Gordana Pavlovic

I. Introduction

Let me begin by giving some background information about the countries on which I will be focusing and about the legal framework that is in place in these countries with regard to IP matters.

The country that used to be called Yugoslavia consists today of five new states:

State	Capital	Population
Slovenia	Ljubljana	two million
Croatia	Zagreb	five million
Bosnia/Herzegovina	Sarajevo	five million
FYR Macedonia	Skopje	two million
Federal Republic of Yugoslavia	Belgrade	ten million

II. Legislation

Each of these states has its own system of intellectual property protection. In other words, each state has its own IP legislation and its own IP Office.

The intellectual property law of the former Yugoslavia (enacted in 1991) is currently applied only in Bosnia and Croatia. Croatia, however, recently passed a new law, which came into force on 1 January 2000, while Bosnia is in the process of drafting a new law. Slovenia and Macedonia have their own intellectual property laws, which were adopted immediately after they proclaimed their independence. In the meantime the Federal Republic of Yugoslavia passed a new trademark law in 1995.

At the international level, the former Yugoslavia was a signatory to the Paris Convention. In the last few years the five new countries have joined as well. Slovenia so far is the only country that has become a member of the World Trade Organization. However, the other countries intend to join as well, and are currently modifying their legislation in order to meet the GATT standards. All five countries have signed the Madrid Agreement on International Registration of Trademarks, while Slovenia and the Federal Republic of Yugoslavia also have signed the "improved version" of Madrid Agreement, the Madrid Protocol.

III. Main Features of Trademark Protection

All five jurisdictions have in common that trademark and service mark rights arise from registration

and not from use. An application for trademark registration must be filed in each country separately: It is not possible to file one trademark application covering all five countries. European Community trademark applications do not cover the five countries of the former Yugoslavia, although this will change as far as Slovenia is concerned when Slovenia joins the European Union.

In Slovenia, trademark applications are examined only on absolute grounds and not on relative grounds. After the examination, the applications are published in the Official Gazette of the Slovenian IP Office and can be opposed by interested parties within a period of three months. The new Croatian IP law is based on the same system. In the other countries, trademark applications are examined both on absolute and relative grounds, and there is no possibility to oppose a trademark application. However, in these countries, trademarks that have been registered even though they did not fulfill all the conditions for trademark protection can be invalidated.

Protection granted to trademarks in the former Yugoslavia before its dissolution extends to the new countries, provided that the trademark in question has been re-registered. All re-registered trademarks retained their priority date of the former Yugoslav trademark registration. Today re-registration is still possible only in Croatia and in Bosnia. In Slovenia and Macedonia the deadlines for re-registration have expired.

Under the Croatian intellectual property law applicable until the end of 1999, a trademark could be re-registered as long as it had not yet expired in Yugoslavia. However, as I indicated earlier, this law was applicable only until the end of 1999. The new Croatian trademark law does not have any provisions regarding re-registration of former Yugoslav trademarks. Therefore, it is likely that re-registration in Croatia is not possible after 31 December 1999.

In Bosnia the deadline for re-registration has formally expired, but the Bosnian IP Office has decided to continue to accept re-registration requests.

In the Federal Republic of Yugoslavia re-registration is not required. All trademarks that were valid in the former Yugoslavia continue to be valid in the Federal Republic of Yugoslavia.

IV. Trademark Use

Use is not a requirement for trademark registration. Therefore, trademarks that are not used and that are not

even intended for use in the near future can be registered. Use is also not required for renewal. Trademarks are renewed in ten-year intervals. At the time of renewal it is not necessary to provide any evidence of use. This is completely different from the U.S. approach, where the applicant must show at least the intent to use the trademark before an application can be filed and must show use before the mark can be registered (unless the registration in the U.S. is on the basis of a foreign registration).

However, trademarks that have not been used for more than five years can be canceled at the request of an interested party. The purpose of a cancellation action is to terminate the validity of a trademark that has not been used, so that a third party can register and use such trademark. This in fact brings me to the actual topic of my paper: I wish to explain to you the conditions that have to be fulfilled and the mechanism in order for a trademark to be canceled.

V. Conditions for Cancellation

In order to cancel a trademark the following four conditions must be fulfilled. It must be shown that:

- The trademark in question was not used.
- The period of non-use exceeded five years.
- There was no justification for the non-use.
- The party that filed the cancellation action has an interest.

A. Use of a Trademark

All relevant countries provide that a trademark must be used on the goods for which it is registered. The burden of proof of use is on the trademark proprietor. As evidence for use, a trademark proprietor can submit, *inter alia*, invoices relating to the sale of goods, labels and tags used to mark the goods, etc. The trademark law of the Federal Republic of Yugoslavia sets, as a minimum, use of a trademark in the advertising of goods for which the mark is registered.

Trademarks must be used in the country of registration. Use in another country does not satisfy the use requirement in the country of registration. However, the new Croatian law provides that the use of the trademark on goods intended for export is sufficient to prevent the cancellation of trademark because of non-use.

The various laws do not specify the quantity of goods that have to be sold or advertised to satisfy the use requirement. This must be evaluated on a case-by-case basis.

A question that is often raised by clients is whether the sale of goods in a tax-free shop satisfies the use requirement. For years many foreign products were

sold only in tax free-shops and not in ordinary stores. Interestingly enough, there is no case law in any of the relevant countries on this matter. We will probably never get the answer, since the question itself has become an academic one. Today, foreign products are readily available in all kinds of shops, and not just tax-free shops. However, the current circumstances create new questions, such as whether the sale of goods in foreign military bases, for example in Bosnia, satisfies the use requirement. This question still remains to be answered.

Finally, a trademark must be used the way it is registered. For example, the Macedonian IP Office held that the sale of Budweiser beer by a Czech company, Budejovicky Budvar, does not satisfy the use requirement for BUD, as BUDWEISER and BUD are two different trademarks. The trademark BUD was therefore canceled in Macedonia.

B. Five-Year Period of Non-Use

A trademark will be canceled only if the period of non-use exceeds five years. This period is calculated as of the registration date of the trademark or as of the date of last use, whatever date expires later. The use itself does not have to be continuous, as long as the period of non-use does not exceed five years.

An interesting question is how to calculate the five-year time period in the case of re-registered trademarks: does one start counting from the date of registration in the former Yugoslavia or from the date of re-registration in the new country? A trademark might have been registered in the former Yugoslavia for more than forty years, but re-registered in one of the new countries only a couple of years ago. In the case of BUD I just referred to, the Macedonian IP Office held that it should be taken into consideration. Since the trademark BUD of Budejovicky Budvar was never used in Macedonia or in the former Yugoslavia, the Macedonian IP Office decided to cancel the mark because of non-use.

C. Justification for Non-Use

Trademarks will not be canceled if the non-use is justified. The various laws do not specify what can serve as a justification for non-use, but the doctrine mentions wars and administrative measures, such a prohibition of imports.

A prohibition of imports is a relatively rare measure, since all five countries are quite open to foreign products. However, other kinds of measures may prevent goods from being put on the market of a particular country. An example is the trade embargo that was imposed on the Federal Republic of Yugoslavia by the United Nations in the period from 1992 to 1995. It could be argued that the UN embargo cannot serve as a justification for non-use, since this measure was not

imposed by local Yugoslav authorities, but by a third party. Such an approach could have been a threat to thousands of mostly foreign trademarks, which were not used in the Federal Republic of Yugoslavia during the embargo when trade with Yugoslavia was prohibited. However, in its decision in the BUD case last year, the Yugoslav IP Office held that the UN embargo could serve as an excuse for non-use. However, according to the Yugoslav IP Office this excuse cannot be used if the trademark was not used before the embargo was imposed.

In Bosnia, the Bosnian IP Office took the official view that the non-use of a trademark during the war in Bosnia, which lasted from 1992 to 1995, was justified. However, this triggers the following question: what if in the same period another party was bringing the same or similar goods onto the market? Is that not an indication that the use was indeed possible, and that therefore war is not always a justification for trademark non-use? A case in which this question was raised is currently pending in Bosnia, and we are awaiting the position of the Bosnian authorities with great interest.

In Slovenia, one of our clients recently argued that he could not have used his trademarks on cigarettes, since otherwise the use of the same trademark on clothing and cosmetics would have been considered to be indirect advertising of tobacco, which in Slovenia is prohibited. Unfortunately, the District Court in Ljubljana did not address this issue at all. Therefore, it is not clear whether this argument can be accepted as a justification for non-use. The case is now pending at the Court of Appeal, and we hope that it will shed some light on this question.

D. Legal Interest

A cancellation action must be filed by an interested party. This is usually a producer who cannot sell his products without infringing the challenged trademark. He therefore must apply for the cancellation of the challenged trademark in order to make this trademark available to him for registration and use.

An interesting example is the battle that has been going on for years between the Slovenian cigarette producer Tobacna Ljubljana and the German producer of men's clothing and cosmetics, Hugo Boss. Tobacna is trying to cancel the trademark BOSS registered by

Hugo Boss for various goods in class 34 (tobacco products). Hugo Boss is arguing that Tobacna does not have a *legal interest* to request the cancellation of its trademark for BOSS since BOSS is a famous trademark which enjoys "extended" protection, beyond goods for which it is registered. Therefore, even if the trademark would be canceled in class 34 because of non-use, Tobacna would still not be able to use it, without infringing the famous trademark BOSS registered by Hugo Boss. The Slovenian District Court accepted this argument and held that as a matter of principle a famous trademark can not be canceled because of non-use, since the plaintiff lacks legal interest. In the case of Hugo Boss, the battle is not over yet, since Hugo Boss still has to prove that BOSS is a famous trademark.

VI. Mechanism

In the countries of the former Yugoslavia, cancellation actions are within the competence of the respective IP Offices. The only exception is Slovenia, where the Slovenian IP Office deals with cancellation actions only if the trademark proprietor has not objected to the cancellation. In such a (rather clear) case, the Slovenian IP Office will cancel the trademark. However, if the trademark proprietor has objected to the cancellation and submitted either the proofs of use or a justification for non-use, or any other argument why the cancellation action should be refused, the case will be referred to the court system.

VII. Conclusion

Trademarks that are not used for more than five years can be canceled at the request of an interested party. However, trademark cancellation is not as straightforward a matter as it may look. Legal provisions in the countries of the former Yugoslavia deal with this matter in a rather general way and many questions still need to be answered in practice. Finding a balance between the interests of trademark owners to preserve their rights and the need to allow interested parties to register and use trademarks that are not used is not always easy.

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Intellectual Property Protection in Poland

By Andrzej Ponikiewski

I. Introduction

Immediately after gaining its independence in 1918, Poland established the Polish Patent Office and in 1919 joined the Paris Convention. The first patent was granted on 24 April 1924 and in the same year the first trademarks were registered. After the Second World War, the patent law proved to be resistant to attempts to introduce the "socialist solutions." Thus, for example, in contrast to other countries of the socialist block, author's certificates were never introduced in Poland as a form of protection. Nevertheless, in practice, patent and trademark protection was of minor importance for state-owned enterprises, although foreign persons enjoyed full exclusive rights.

In 1972 a new Law on Inventive Activity was adopted, which, with some later amendments, is still in force. This law strengthened the role of the inventor and proprietor of the invention.

The recent changes in the Polish economic system, now based on free market principles, as well as the fact that Poland has joined international treaties and concluded bilateral treaties (including one with the United States in 1990), has resulted in amendments to the law. Also, the aspiration of Poland to join the European Union has led to changes, since one of the conditions for joining the Union is that Poland must provide the same level of protection as in other countries which are members of the Union. Poland's desire to join the European Patent Organization also required changes of the patent law to fully harmonize it with the European Patent Convention. Some changes were also necessary in order to sign TRIP's agreement.

These changes resulted, among other things, in prolongation of the validity of patents to twenty years (formerly fifteen), introduction of protection for chemical compounds per se, and protection for "pharmaceutic" compositions and foodstuffs.

At present, Poland is a member of the Paris Convention (Stockholm text), the Convention establishing the World Intellectual Property Organization (1975), the Madrid Agreement Concerning the Suppression of False Indications of Origin (1928), the Patent Co-operation Treaty (1990), the Madrid Agreement Concerning the International Registration of Trademarks (1991), the Protocol Relating to the Madrid Agreement (1997), the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (1997), the Budapest Treaty on

the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (1993), and the Nairobi Treaty on the Protection of the Olympic Symbol (1996). Since 1995 Poland is a member of WTO and since 1997 enjoys the status of an observer of the European Patent Organization and will be admitted to this Organization in the year 2002.

II. Patents and Utility Models

A. Patents

Protection of inventions and utility models is currently governed by the Law on Inventive Activity of 1972, as amended. This law in its present shape defines in its Article 10 a patentable invention as any *new* solution of a *technical* character which does not obviously result from the prior art and which is capable of practical application. A new solution has to be absolutely novel, which means that the invention must not have been made available in any way to the public before the date determining the priority for obtaining a patent.

The law specifies in its Article 12 some exemptions from patent protection, including the following.

- New plant varieties and animal breeds as well as biological processes, and the cultivation of plants or breeding of animals, may not be patented, although new varieties of plants may be protected under another law.
- For humanitarian reasons, in order not to prevent the public from the possibility of using such methods by granting the exclusive rights, methods for treatments of diseases in the field of medicine and veterinary and in plant protection may not be patented.
- Inventions whose exploitation would be contrary to law or public policy are not patentable.
- Since they are protected by copyright law, computer programs are likewise not patentable.
- Products obtained by nuclear transformation may not be patented.
- Scientific theories and discoveries are not patentable, since these only confirm objectively existing phenomena and lack a technical character.

Note that the exclusion of biological processes does not prevent the possibility of patent protection for

processes utilized to obtain some useful product, such as an antibiotic obtained by a microbiological process.

It is worth mentioning that neither a specific “use” nor the more common “second use” of a known substance has been patentable. Only lately, as a result of an appeal, were two patents granted for a composition for treatment of a certain disease, where such composite contains as an active substance a known compound. Such protection is, practically speaking, similar to the “use” category, but the scope of such protection is very narrow.

A right to obtain a patent belongs to the inventor and is transferable. There are also “employee inventions,” when the invention was made by an inventor performing his employment duties or other contract obligations. In such a case the right to obtain a patent belongs to the employer.

Patent applications are published eighteen months after the date established as the priority date. Granted patents are also printed after payment of the printing fee.

There is no opposition procedure allowed against granting a patent, although any person may provide to the Patent Office, within six months from the date that the application is published, any material against the patentability of the invention. These materials are taken into account in the course of the examination.

A patent, which lasts twenty years from the application date on the condition that annual fees are paid, is granted after an examination carried out “ex officio,” and gives its owner the exclusive right to exploit the invention for deriving profits therefrom. The patent may be exploited by its owner, or it may be sold or licensed. However, the exclusive rights resulting from a patent cannot be abused by applying prohibited monopolistic practices. As a measure of preventing the abuse of the exclusive rights of patent, the law provides for a compulsory license, which may be granted only in litigation proceedings and may not be imposed earlier than three years after the patent in question was granted, where:

- it is necessary to prevent or eliminate a national emergency; or
- the patentee does not fulfill a social need without any justified reasons or the patentee prevents the meeting of a social need by refusing to conclude a license contract with the owner of a dependent patent.

In every case the owner of a patent over which the compulsory license is granted is entitled to payment to the patent owner of royalties paid by the licensee.

Despite these apparently severe rules, the rules have, to my knowledge, never been yet applied against a foreign applicant.

In the event of infringement the owner of a patent may sue the person committing the act of infringement in civil court and demand that the infringer cease the infringement, redress the consequences of such infringement, and surrender any profits derived or compensate for damages suffered, as well as publish an appropriate statement in the newspapers and pay an adequate amount of money to social organizations who actively encourage inventive activity. Such a person may also be subject to imprisonment for a term not exceeding one year.

Marking goods to give notice that they are protected by patent is permitted, but is not obligatory. However, putting on the market falsely marked goods or marking goods to give a false impression that they enjoy patent protection is punishable by detention or limitation of freedom not exceeding three months or a fine.

Any person having a legal interest may seek in a litigation proceeding to have the granted patent declared null and void. The basis for such a request may be lack of novelty, obviousness or lack of technical applicability. The burden of proof is on the petitioner.

All decisions and official actions of the Patent Office are subject to the control of a Board of Appeal, which is an independent body administered by the Patent Office. There is no case law in Poland, and each case is considered independently. However, the decisions of the Board give some guidelines as to the practices of the Patent Office.

B. Utility Models

The same provisions that apply to patents apply to utility models as well. The utility model is defined in Article 77 of the Law as any new and useful solution of a technical nature affecting shape, construction or permanent assembly of an object. Utility models are often called “small inventions.” The basic difference in comparison to the invention is that, for utility models, only novelty is required and there is no requirement of non-obviousness. In addition, the term of protection is only five years from the filing date, although it may be prolonged on request and after payment of the prescribed fee for a subsequent period of an additional five years, meaning that ten years of protection is the maximum.

The application for a patent may, on request, made within two months after the date of a decision refusing to grant a patent, be changed into a utility model application.

III. Trademarks

Trademarks are protected under the Law on Trademarks of 31 January 1985. This law defines a trademark as “any sign capable of distinguishing the goods or services of a given enterprise from similar goods or services of another enterprise.” It may be a word (or words), a design, or any ornament, a combination of colors, plastic forms, melodies or other acoustic signals, and a combination of such elements. They may be registered on behalf of an enterprise or a natural or legal person carrying out economic activities.

The feature determining whether the trademark is registrable is its sufficient distinctiveness in comparison to other trademarks, thereby enabling one to establish the origin of goods and services. The trademark cannot mislead the public as to the origin of goods and services.

There are some exclusions from registrability. A trademark cannot be registered if:

- it is contrary to law or principles of society;
- it infringes the personal or economic rights of third parties;
- it contains incorrect statements;
- it contains the name or abbreviated name of the Republic of Poland, its symbol, national colors or national anthem, the insignia of military forces;
- it contains quality or safety marks;
- it contains the name of armorial bearings of Polish voievodships, towns or communities, an honorary or military medal or military insignia (the approval of the competent organs are required for such registration);
- it contains the name, abbreviated name or symbols of a member State of the Paris Union or intergovernmental organizations to which at least one of those States belongs, or the Olympic symbol unless allowed.

There are also some limitations on the registration of trademarks for goods of the same kind. For goods of the same kind the registration of a trademark is not permissible where:

- it is similar to a trademark already registered on behalf of another enterprise (thereby misleading the public as to the origin of goods or services);
- it is similar to a trademark well known in Poland;
- it is similar to a trademark previously registered in Poland for which protection has already

expired, unless three years has already passed since the expiration of the right deriving from the other registration;

- it constitutes the protected denomination of a plant variety;
- it contains the reproduction of an official seal or warranty sign, although registration is possible if evidence is submitted proving authorization to use such stamp or sign;
- it contains geographical or other elements of the member States of the Paris Union or region or community of such State in respect of goods that do not originate in such State and may mislead the purchaser as to the origin of the goods.

Registration is granted after examination as to whether the statutory requirements for registration are fulfilled.

The use of the registered trademark is obligatory and the failure to use the registered trademark within three consecutive years after the issuance of the decision to grant the registration results in the expiration of the right. Moreover, the trademark right derived from the registration may be annulled at the request of any person having an interest in such action on the ground of non-use or lack of other conditions for registration.

The registration of a trademark, its extension, the transfer of rights deriving from registration, the granting of a license, the lapse of rights deriving from a registration, the annulment of a registration, changes of the owner, and changes to the list of goods are all announced in the official gazette of the Patent Office entitled *Wiadomosci Urzedu Patentowego*.

The registration of a trademark granted by the Patent Office gives the owner the exclusive right to use the trademark throughout the national territory in its economic activities for goods covered by the registration. The rights deriving from the registration last for ten years from the date of filing the application for registration with the Patent Office and may be extended for further ten-year periods after payment of the renewal fee.

The rights deriving from registration may be assigned or licensed. License agreements must be drawn up in writing and are effective against third parties only after entry in the Trademark Register. A licensee has the same rights as the owner of the registration. Anyone placing on the market goods bearing a trademark when that person is not entitled to do so is subject to imprisonment for up to one year, limitation of freedom for to one year, or a fine.

The owner of the rights deriving from the registration of the trademark or a licensee may sue any infringer in the civil court within three years after the date an act of infringement is discovered. The trademark owner may require cessation of acts of infringement, payment of damages, surrender of the unlawful profits and also publication of an appropriate statement. The court, on request, may order the seizure of goods, packaging and other objects on which the registered mark is affixed or the seizure of any means used for marking the goods with such sign.

Well-known marks also enjoy protection in Poland. The user of such a well-known mark, not registered in Poland, may request the annulment of an infringing registration within five years and the prohibition of the use of the mark by other enterprises. After five years have passed since such infringing registration, such user of a well-known mark may only require the necessary alteration to exclude any risk of misleading a purchaser as to the origin of the goods and services.

The law also provides protection for collective marks.

IV. Other Proprietary Rights

It is also worth mentioning that, besides patents, utility models and trademarks, there also exist in Poland other forms of protection, such as protection of ornamental designs and protection of the topography of integrated circuits. It is possible to protect the same object as a utility model, an ornamental design and a trademark. Also, protection may be available under the Copyright Law (such as for computer programs) and the Law on Unfair Competition.

V. Expected Changes in the Laws

Although the Polish patent law is harmonized with the European law, there are some requirements resulting from TRIPs and the new Constitution of Poland which will have to be taken into account. That is, right now final intensive work is carried out in the Polish Parliament on the "Law on Industrial Property," which probably will come in force at the beginning of 2000. This law will gather in one act provisions relating to the protection of inventions, utility models and trademarks, for which exclusive rights will be granted after examination, and to the protection of the topography of inte-

grated circuits, industrial designs (a new form of protection replacing ornamental designs) and geographical denominations, for which protection will be granted in a registration procedure without examination.

Among the important new rules, the following should be mentioned.

- In regard to patents, patentability will be defined on the basis of Article 52 of the European Patent Convention. Patents will also be granted for the use of a known substance for a new application as well as for the use of a known substance to prepare a composition for a new application.
- Provisions relating to compulsory licenses will be in full agreement with TRIPs regulations.
- As far as trademarks are concerned, the new law will adopt the provisions of the First Council Directive No 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trademarks and will assure that, in the case of conflicts of the national norms with the international agreements, the international norms prevail. Such international norms will be also considered for purposes of interpreting the law.
- The draft of the new law states also that, in cases when the statutory requirements are not met in respect to some goods only, the Patent Office cannot refuse the registration of a trademark in respect to the rest of the goods included in the list of goods.
- Also, a definition of counterfeited trademark will be introduced as well as the possibility to seize at the border goods bearing a false trademark.
- A concept of national exhaustion of rights will be introduced both for patents and trademarks.
- A Patent Court will be established and all decisions of the Patent Office will be subjected to the court's control.

Set forth in the Appendix of this Article are some comparative statistical tables.

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APPENDIX

TABLE 1: Exclusive rights in force in Poland at the end of 1997 and 1998

	1997	1998
Inventions	13704	13589
Utility models	2729	2749
Trademarks	78640	92750
Ornamental designs	2995	3590

TABLE 2: Number of patent applications filed in Poland in 1995 - 1998

	1995	1996	1997	1998
under the national procedure	3860	3708	3644	3635
- domestic	2595	2411	2399	2407
- foreign	1265	1297	1245	1228
Designation of Poland (PCT)	14976	20136	24881	30981
Entering the national phase	1610	1965	2703	2900

Distribution of designations of Poland in PCT applications according to the country of origin: USA - 14358; United Kingdom - 2419; Sweden - 1507; France - 1080; Japan - 835; Canada - 810; Finland - 775; Australia - 769; Germany - 613; Denmark - 500; other - 7315.

TABLE 3: Number of utility model applications in 1995 - 1998

	1995	1996	1997	1998
Total	2163	1853	1639	1599
- domestic	2119	1800	1589	1525
- foreign	44	53	50	74

TABLE 4: Number of trademark applications in 1995 - 1998

	1995	1996	1997	1998
Total number under national procedure	12889	13396	13600	14405
- domestic	9752	9860	10308	11263
- foreign	3137	3536	3292	3142
Total number of notifications on registration under Madrid Agreement	7220	6809	9157	9843

Distribution of the number of trademark applications filed under the national procedure: Poland - 11263; USA - 1396; United Kingdom - 266; Germany - 235; Sweden - 152; France - 123; Japan - 119; Switzerland - 105; others - 746.

Distribution of the number of trademark applications filed under the Madrid Agreement according to the country of origin: Germany - 38.3%; France - 17.2%; Switzerland - 10.9%; the Benelux countries - 9.5%; Italy - 8.6%; Austria - 4.2%; Spain - 3.4%; Czech Republic - 1.4%; others 6.5%.

(All figures based on the Yearly Reports of the Patent Office of the Republic of Poland.)

Modernizing for the Millennium: The 1999 Amendments to the Trademark Law

By John L. Welch

As we practitioners prepare to trek across the bridge to the twenty-first century, several recent developments in American trademark law will help make our journey just a bit easier. The U.S. trademark system is being modernized so that this country's trademark owners may more readily protect their trademarks in the electronic global marketplace.

The many changes that United States trademark law has undergone in the year 1999 result from two legislative enactments: the Trademark Amendments Act of 1999, and the Trademark Law Treaty Implementation Act. The former addressed several significant substantive issues and made a few technical corrections to the Lanham Act, while the latter is directed to some rather fundamental changes in the procedural aspects of trademark practice.

I. The Trademark Amendments Act of 1999

This Act (Public Law 106-43) comprises not so much a modernization effort as a clarification and, in some respects, a broadening of the trademark law. The 1999 Act took effect upon its signature by President Clinton on 5 August 1999. A copy of the Act may be found at <http://thomas.loc.gov/>. Its key provisions are as follows.

A. Dilution

Section 2 of the 1999 Act amends the Lanham Act to include dilution under Section 43(c) as ground for opposition under Section 13(a) and as ground for cancellation under Section 14. Dilution is not, however, a basis for *ex parte* refusal to register under Lanham Act Section 2. The 1999 Act states, rather cryptically, that this section applies "only to any application for registration filed on or after January 16, 1996."

Section 3 of the 1999 Act amends the Lanham Act to make it clear that injunctive relief (Section 34(a)) is available in a dilution action, but that monetary recovery (Section 35) and/or destruction of infringing articles (Section 36) will be available only if willfulness is proved.

B. Governmental Immunity

Section 4 of the 1999 Act eliminates the immunity of the federal government from suit for violation of the Lanham Act. It expands the definition of "any person" in Sections 32 and 45 to include the United States, its agencies, instrumentalities, and any entities or persons

acting for it. Section 40 of the Lanham Act has been rewritten to expressly state the waiver of sovereign immunity by the United States.

C. Trade Dress Burden of Proof

Section 5 of the 1999 Act amends Section 43(a) to provide that, in a civil action for infringement of trade dress not registered on the principal register, the party that asserts trade dress protection has the burden to prove non-functionality.

II. The Trademark Law Treaty Implementation Act

The real modernization of American trademark law stems from the passage of the Trademark Law Treaty Implementation Act (Public Law 105-330) ("TLTIA"), signed by President Clinton on 30 October 1998. TLTIA amends the Lanham Act to comport with the June 1998 ratification of the Trademark Law Treaty by the United States. The provisions of Title I of TLTIA took effect on 30 October 1999. A copy of this Act may be found at <http://www.thomas.loc.gov>.

A. The Trademark Law Treaty

The Trademark Law Treaty ("TLT") was signed in Geneva, Switzerland, in October 1994, and is administered by WIPO. A copy of the Treaty may be found at www.wipo.org. The impetus for the TLT was the desire to lessen the difficulty and expense involved in protecting and maintaining trademarks globally. The goal of the Treaty is to harmonize certain procedures of national trademark offices and to establish "maximum" requirements that may be imposed for trademark applications (Article 3) and for the granting of filing dates (Article 5). The Treaty seeks to eliminate many formal requirements governing renewals, recordation of assignments, changes of names or addresses, powers of attorney, drawings, and signatures. Of particular interest is the elimination in Article 8 of the requirement for attestation, legalization, authentication, or other certification of any signature on a document (except for a surrender of registration). Parties to the Treaty include Australia, Japan, and the United Kingdom.¹

Title I of the Trademark Law Treaty Implementation Act implements the provisions of the TLT. Titles II and III are unrelated to the TLT: they are directed to substantive changes in the U.S. law, and became effective on 30 October 1998, when the Act was signed. Title II amends the Lanham Act at Sections 2(e), 2(f), and 23(c) to codify case law and PTO practice that refuses regis-

tration of matter that is *de jure* functional. It also provides at Section 14(3) that functionality is a ground for cancellation that may be raised more than five years after the registration date, and, pursuant to Section 33(b) is a statutory defense in an infringement suit involving an incontestable registration. Title III deals with clarification in Section 14 of the grounds for cancellation of a certification mark, and with the initiation of a study of possible protection for official insignia of Native American tribes.

On 8 September 1999, the amended Trademark Rules of Practice under the TLTIA were published in the Federal Register. These new Rules took effect on 30 October 1999. They may be found, along with the PTO's commentary, at http://www.access.gpo.gov/su_docs/aces/aces140.html in ".pdf" format.

B. Two Other Important Treaties, Briefly

Before we focus on the TLT and TLTIA, it may be helpful to review briefly two other important trademark-related treaties, the Paris Convention and the Madrid Protocol. The United States is, of course, a member of the former, but has not adhered to the latter.

The Paris Convention

The Paris Convention for the Protection of Industrial Property was signed in 1883, and deals with patents, trademarks, and unfair competition. Its members number more than one hundred thirty, and together constitute the "Paris Union."

With regard to trademarks, the keystone of the Paris Convention is the principle of "national treatment"—each member agrees to give citizens of another member state no less favorable treatment than it gives its own citizens. It also establishes certain minimum levels of protection, such as effective protection against unfair competition, and it provides for convention priority. The Paris Convention also created a legal entity under international law, which entity includes an Assembly of all member nations, an Executive Committee, and an International Bureau of The World International Property Organization (WIPO).

The Madrid Protocol

While the Paris Convention recognized the territoriality of trademarks—*i.e.*, the concept that a mark exists only under the laws of a particular nation—the Madrid Protocol seeks to provide an international trademark registration system. Nationals of countries that are members can secure multinational protection for a trademark based upon an application filed in the home country, by designating those other member countries in which protection is sought. The trademark office in each designated country is then notified of the applica-

tion, and has the right to refuse protection. The payment of a single fee and preparation of a single application, with resultant savings in legal fees (at least initially), is a main benefit of this scheme. The Madrid Protocol became effective in 1996, and has been ratified by a handful of countries.

In the early 1990s considerable interest in the Madrid Protocol was shown in the United States, but the issue has been rather dormant for some time. A bill was introduced in Congress in 1999 to implement the Madrid Protocol, but has not progressed. The status of this legislation may be monitored at <http://thomas.loc.gov>. A principal stumbling block to U.S. acceptance of the Protocol is the concern about double counting of votes for international organizations such as the European Union and its individual members. A succinct discussion of the Madrid Protocol may be found at <http://www.ladas.com/Madrid.html>.

C. Implementation of The Trademark Law Treaty

As indicated, the TLT is intended to reduce the difficulty and expense that trademark owners endure in protecting and maintaining their trademark properties in a global market. Certain changes in U.S. procedures were necessary in order to comply with the treaty provisions.

The TLTIA effects changes in Sections 1, 8, 9, 10, 12, and 44 of the Lanham Act. These changes fall primarily into five areas:

- The application for registration and its verification.
- The revival of abandoned applications.
- Post-registration filings.
- PTO recordation of documents.
- Assignment of ITU applications.

This paper does not attempt to discuss every change made by the TLTIA, nor every new wrinkle in the regulations. Rather, it discusses some of the more interesting and/or substantive changes.

1. The Application for Registration and its Verification

Of the many changes brought about by TLTIA, the most fundamental may be in the minimum requirements for receiving an application filing date.

The TLTIA gives the Commissioner authority to set by regulation the requirements for receiving a filing date; in other words, there will no longer be any "statutory" *filing date* requirement that the Commissioner cannot change or waive.

(a) Filing Date Requirements

The PTO is amending Trademark Rule 2.21 to require only the following elements for receipt of a filing date:

- The name of the applicant.
- A name and address for correspondence.
- A clear drawing of the mark.
- A list of the goods or services.
- The filing fee for at least one class.

The following elements will no longer be required for receiving a filing date: a signature; a stated filing basis; an allegation of the applicant's use or bona fide intention to use the mark in commerce; a specimen and dates of use in a Section 1(a) application; a claim of priority in an application based on Section 44(d); and a certified copy of the foreign registration in a Section 44(e) application. *Instead, these elements will be required subsequently during examination.*

Needless to say, these changes to the filing date requirements should reduce the mental strain on the typical U.S. practitioner. No longer must one worry about being denied a filing date because of some minor oversight, like failing to state a basis for registration, or failing to include a signature.

It seems likely that, in most cases, practitioners will continue to file, at the outset, complete applications that contain all of the elements that will ultimately be required. Otherwise, substantive examination of an application may be delayed until the required information or element is provided, perhaps in response to a non-substantive first office action.

However, one can certainly envision situations that call for an immediate filing of what is less than a complete application. For example, when faced with a priority deadline (perhaps because of a last-minute request from a foreign client or associate), one might file a minimal application to preserve the priority date. Or a practitioner may not be sure of the dates of use, or may not have a proper specimen, or may not want to wait for further information requested of a client, and so may choose to file immediately to secure as early a filing date as possible.

(b) Requirements for a "Complete Application"

The Lanham Act has been amended to distinguish between the application and the declaration of use and/or intent to use for purposes of the signature requirement ("the verified statement"). The TLTIA amends Section 1 of the Lanham Act to state that a trademark owner may request registration by paying

the required fee and by filing "an application *and* a verified statement." (Emphasis supplied.)

United States law currently requires verification of all of the elements of the application. However, Article 3 of the Trademark Law Treaty permits verification *only* of the Applicant's use or intention to use the mark. The TLTIA amends the Lanham Act to comport with the Treaty.

(c) The Application

New Rule 2.32 sets forth the requirements for a "complete application."² The required elements comprise most of the elements required under current law. The application must be in English and must include:

- A request for registration.
- The name of the applicant.
- The citizenship of the applicant, or if the application is a juristic person, the jurisdiction under the laws of which the applicant is organized, and if a partnership, the names and citizenship of the general partners.
- The address of the applicant.
- One or more bases for registration (including dates of use, where appropriate).
- A list of goods and/or services.
- The international class(es), if known.
- A verified statement.
- A clear drawing.
- The appropriate fee.

No longer required, however, is a specification of the *type* of commerce in which a mark is used, whether in an application, a statement of use, a Section 8 declaration of continued use, or a Section 15 incontestability declaration. The Office will assume that an applicant who states that the mark is in use "in commerce" is stating that the mark is in use in a type of commerce that Congress can regulate.³ Also no longer required, in compliance with the TLT, is a statement of the "manner of use" of the mark.

If the applicant wishes to claim color as a distinctive feature of the mark, it must include a statement to that effect as well as the name of each color and an indication of the parts of the mark that are in that color. The color lining chart of Rule 2.52(e) will be deleted from the regulations. However, drawings using the color linings will still be accepted by the PTO until further notice. If a drawing is filed in color, the PTO will no longer deny a filing date.⁴ The PTO anticipates publishing and issuing marks in color in the future.

(d) The Verified Statement

(i) In a Use-Based Application

For a use application, amended Section 1(a)(3) of the Lanham Act provides that “[t]he statement” shall be verified⁵ by the applicant and specify that:

- (A) the person making the verification believes that he or she, or the juristic person in whose behalf he or she makes the verification, to be [sic] the owner of the mark sought to be registered;
- (B) to the best of the verifier’s knowledge and belief, the facts recited in the application are accurate;
- (C) the mark is in use in commerce; and
- (D) to the best of the verifier’s knowledge and belief, no other person has the right to use such mark in commerce either in the identical form thereof or in such near resemblance thereto as to be likely, when used on or in connection with the goods of such other person, to cause confusion, or to cause mistake, or to deceive. . . .

It is noteworthy that the Lanham Act requires verification that “the facts recited in the application are accurate.” This seems to violate the TLT’s prohibition of requiring verification of anything other than the averment of use or intent to use.⁶

The Commissioner is empowered by the Lanham Act to promulgate rules prescribing the requirements for an application. The new PTO regulations re-state the listed statutory requirements for a use application in slightly different language, and further require in the verified statement an averment that “the specimen shows the mark as used on or in connection with the goods or services.” New Rule 2.33(b)(1). This new rule also requires that the applicant verify “that the facts set forth in the application are true,” despite the aforementioned TLT prohibition against such a requirement.

The PTO has reduced the number of specimens required in a use application from three to one. New Rule 2.34(a)(1)(iv). For an electronically transmitted application pursuant to New Rule 2.56(d)(4), the specimen, not surprisingly, must be submitted as a digitized image. Specimens should be flat and not larger than 8.5 inches by 11.69 inches. If a specimen exceeds this size (“a bulky specimen”), the applicant may substitute a suitable photograph or facsimile. If the applicant submits a bulky specimen, the PTO will create a facsimile specimen of proper size, and will destroy the submitted specimen. Under New Rule 2.56(d)(1)-(3), in the absence of non-bulky alternatives, the PTO may accept an audio or video cassette tape recording, CD-ROM, or other appropriate medium.

(ii) In an Intent-to-Use or Section 44 Application

For an intent-to-use application or an application under Section 44, the statement must, according to amended Section 1(b)(3) of the Lanham Act, be verified by the applicant, and specify:

- (A) that the person making the verification believes that he or she, or the juristic person in whose behalf he or she makes the verification, to be [sic] entitled to use the mark in commerce;
- (B) the applicant’s bona fide intention to use the mark in commerce;
- (C) that, to the best of the verifier’s knowledge and belief, the facts recited in the application are accurate; and
- (D) that, to the best of the verifier’s knowledge and belief, no other person has the right to use such mark in commerce either in the identical form thereof or in such near resemblance thereto as to be likely, when used on or in connection with the goods of such other person, to cause confusion, or to cause mistake, or to deceive.

New Rule 2.33 recites these requirements in slightly different terms, and mistakenly omits the words “in commerce” after the phrase “applicant is entitled to use the mark.” Again, this Rule requires that the applicant verify “that the facts set forth in the application are true,” in spite of the aforementioned TLT prohibition against such a requirement.

As indicated, in an application based on registration of a mark in a foreign applicant’s country of origin (Section 44(e) of the Lanham Act), or based on an earlier-filed foreign priority application (Section 44(d) of the Act), the applicant must file a verified statement that it has a bona fide intention to use the mark in commerce in connection with the goods or services listed in the application.

In all three situations (ITU, Section 44(e), and Section 44(d)), if the verified statement does not accompany the original application under New Rule 2.34, the later-filed verified statement must allege that the applicant had a bona fide intention to use the mark in commerce *as of the filing date of the application*.

(iii) Multiple Bases for Filing and Changing Bases

In a marked change from present practice, New Rule 2.34 permits an applicant to claim any or all of the four filing bases for the different goods and/or services *in a single application*. Rule 2.86(c), which prohibits an applicant from claiming use and intent to use in a single, multi-class application, will be deleted. Of course, pursuant to New Rules 2.34(b)(1) and 2.86(a)(3), an applicant may not claim a basis under both Sections 1(a)

and l(b) for the *same* goods or services in the same application.

New Rule 2.35 provides for adding, deleting, or substituting bases under most conditions. For example, a use-based application may be amended to substitute an intent-to-use basis. Of course, neither the identification of goods nor the recitation of services may be broadened by amendment.

(iv) Who May Sign the Verified Statement

In New Rule 2.33, the PTO has significantly relaxed the signature requirement with regard to the verified statement. The statement may be signed by a person with legal authority to bind the applicant, by a person with firsthand knowledge of the facts and with actual or implied authority, or by an attorney⁷ who has an actual or implied written or verbal power of attorney from the applicant.⁸

Thus as of 30 October 1999, an attorney is permitted to sign the verified statement on behalf of his or her client. Most attorneys will undoubtedly move cautiously to embrace this new provision. When a client signs an application, there is presumably no room for later argument about whether the filing was authorized by the client. Furthermore, an attorney who signs a verified statement may find himself or herself in the role of fact witness in some later legal proceeding involving the mark, with possible resulting complications, including disqualification as an attorney in the proceeding. Waiver of the attorney-client privilege could also prove to be a problem.

(e) Power of Attorney and Appointment of Domestic Representative

New Rule 2.17(c) codifies present practice in stating that, to be recognized as a representative in a trademark case, an attorney may file a power of attorney, appear in person, or sign a paper that is filed with the Office on behalf of an applicant or registrant. In accord with the TLT, pursuant to New Rule 2.17(d), a written power of attorney may relate to more than one application or registration, or to all existing and future applications and registrations of a party. Pursuant to Rule 2.18, correspondence from the PTO will be sent to the attorney of record, or if none, to the applicant or a party to a proceeding.

As to the appointment of a domestic representative, the requirement of Lanham Act Section l(e) remains unchanged. If an applicant is not domiciled in the United States, the applicant must designate some person residing in the United States upon whom may be served notices or process in proceedings affecting a mark. As in current practice, if the appointment does not accompany the application, it will be required later. Pursuant to Rule 2.24, the domestic representative may be someone other than the attorney of record.

To reiterate, the TLTIA provisions and the new regulations apply to all applications pending on, or filed on or after, 30 October 1999.

2. The Revival of Abandoned Applications

Under current law (Section 12(b)), the Commissioner may revive abandoned applications only upon a showing of *unavoidable* delay. For intent-to-use applications, according to Section 1(d)(4) the failure to timely file a verified statement of use “shall result in abandonment.”

The TLTIA amends the Lanham Act to provide a much more lenient standard for revival, namely “unintentional” instead of unavoidable. This change parallels the unintentional standard available to patent applicants. The unintentional delay standard applies only to a delay in responding to an Office Action, or in filing a statement of use or a request for an extension of time to file a statement of use. Section 12(b) is amended to substitute the word “unintentional” for “unavoidable,” and, in the case of intent-to-use applications, Section 1(d)(4) is re-written to provide for revival if the delay in responding was unintentional (as long as the period for filing the statement of use is not extended beyond the statutory maximum period of thirty-six months from the date of the notice of allowance).

The petition to revive must be filed (1) within two months of the mailing date of the notice of abandonment or (2) within two months of actual knowledge of the abandonment, if the applicant did not receive the notice of abandonment and the applicant was diligent in checking the status of the application. To be considered diligent, an applicant must check the status of the application within one year of the last filing or the last receipt of a notice from the Office for which further action by the Office is expected. Pursuant to New Rule 2.66, the petition must be signed by someone with firsthand knowledge of the facts, but it need not be verified or supported by a declaration.

3. Post-Registration Filings

The renewal and Section 8 procedures are made slightly more complicated under TLTIA, but additional time is made available to effect these filings, and most deficiencies in the filings may be corrected.

(a) Renewals

Under Article 13(4)(iii) of the TLT, a contracting party may not require a showing of use of a mark as part of a request for renewal. Of course, this prohibition is in direct conflict with current U.S. law. In this country, we are concerned with “dead wood” clogging the register, and therefore current U.S. law requires proof of continued use at the time of each renewal. If such proof is not provided, the mark is removed from the register.

The TLT does not prohibit a requirement for a periodic filing of a declaration and/or evidence of use in connection with a registration, so long as it is not part of the requirements for renewal.⁹ Therefore, the TLTIA complies with the TLT by removing from Section 9 any requirement of proof of use in the renewal application. In turn, the TLTIA adds to Section 8 a requirement that an Affidavit or Declaration of Use be filed not only during the sixth year of life of a registration, but also during its tenth year, and every ten years thereafter.

Thus a registration owner will be required to file, at ten-year intervals, both a renewal application and a Declaration or Affidavit Under Section 8, in order to keep the registration in force.

Under current law, a renewal application may be filed within the period beginning six months prior to the expiration date of the registration, or within a three-month grace period after that date (with payment of an additional fee). Under the amended law, the renewal application may be filed within one year prior to the expiration date, or within a six-month grace period after that date (with payment of a \$100 “grace period surcharge” per class).

Under New Rule 2.183, a complete renewal application must include (1) a request for renewal signed by the registrant or the registrant’s representative; (2) the prescribed fee; (3) any grace period surcharge; (4) an appointment of domestic representative, where appropriate; and (5) a list of the particular goods or services to be renewed, if less than all.

Amended Section 9 allows for correction of a deficient renewal application, but a “deficiency surcharge” (\$100) may be required, depending on when the corrected application is filed: if filed during the one-year period prior to the expiration date, then no surcharge is required; if filed after the expiration date, a deficiency surcharge may be required.¹⁰ TLTIA does not define deficiency, nor place any limits on the type of error that may be cured. However, under New Rule 2.185 the failure to file a renewal application within the statutory time periods is not curable. The period for correcting the deficiency will be prescribed by the PTO in the notice of deficiency.

These new renewal provisions apply to registrations whose expiration date is on or after 30 October 1999 and whose application for renewal is filed in the PTO on or after that date. It may be wise to delay filing renewal papers until after 30 October 1999, where possible, to gain the advantage of the new provisions for correcting deficiencies.

(b) Section 8 Declarations of Continued Use

As indicated, the provisions of the TLTIA require the declaration of continued use not only at the sixth

anniversary of a registration, but also at its tenth anniversary, and at each successive tenth anniversary. Verification of the continued use (or excusable non-use) of the mark in question is no longer required in the Section 9 renewal application, but rather is required in a separate Section 8 Declaration.

Currently, a Section 8 Declaration is to be filed during the one-year period between the fifth and sixth anniversary dates of the registration. The amended law allows the filing of the Section 8 Declaration during that one-year period, or within six months after the sixth anniversary date (with payment of a \$100 “grace period surcharge” per class). The tenth-year Section 8 Declaration may be filed during the one-year period before the tenth anniversary date, or within the six-month period after that date (with payment of a “grace period surcharge”). Subsequent Section 8 Declarations are similarly required every ten years thereafter.

Again, the amended Act allows for the correction of deficient filings after the statutory period expires. Depending on when the corrected filing is made, a \$100 “deficiency surcharge” may be required. Under New Rule 2.164, if the corrected papers are filed during the year before the anniversary date, no deficiency surcharge is required; if filed after the anniversary date, a surcharge may be due. The period for correcting the deficiency will be prescribed by the PTO in the notice of deficiency. The Section 8 Declaration must be filed by the *owner* of the registration, and must be filed within the time periods set forth in Section 8 of the Act. An error in either regard is not a deficiency that can be cured.

The TLTIA applies to Section 8 Declarations for registrations whose sixth or tenth year anniversaries fall on or after 30 October 1999, *if* the Declaration is filed on or after 30 October 1999. Again, it may be wise to delay filing a Section 8 Declaration until after 30 October 1999, where possible, to gain the advantage of the new provisions for correcting deficiencies.

TLTIA amends Sections 8 and 9 of the Lanham Act to make it clear that an appointment of domestic representative is required with post-registration filings if the registrant is not domiciled in this country.

It is expected that the Section 8 Declaration and the Section 9 Application for Renewal will be filed simultaneously. The PTO will accept a combined “Sections 8 and 9” form, so that both filings may be made in a single document.

(c) Certain Twenty-Year Registrations

Since 16 November 1989, the effective date of the Trademark Law Revision Act of 1988, trademark registrations have been issued and/or renewed for ten-year terms. However, many registrations currently exist that

are enjoying a twenty-year term—because they were issued prior to 16 November 1989, or are in a renewal term that began prior to that date.

Section 8, as amended by the TLTIA, affects registrations whose sixth or tenth anniversary falls on or after 30 October 1999. Registrations that issued or were renewed prior to 30 October 1989 will not be subject to the 10-year Section 8 requirement, because their tenth anniversary dates will fall before the effective date of TLTIA.

But what about registrations issued for a twenty-year term during the period 30 October 1989 to 16 November 1989, or registrations renewed for twenty years when their expiration dates fell in that period? Those registrations¹¹ will have a tenth-anniversary falling *after* 30 October 1999, the effective date of TLTIA. Will a tenth-year Section 8 Declaration be required for these registrations? The PTO says no. In its comments on the Final Rules issued on 8 September 1999, the PTO states that the new tenth-year Section 8 requirement does not apply to a registration issued or renewed for a twenty-year term until a renewal application is due.¹² See the PTO's commentary on the amended Rules of Practice, at page 48,900 of the 8 September 1999 Federal Register.

4. PTO Recordation of Documents

Section 107 of TLTIA makes several changes pertaining to the recordation of documents by the PTO. These changes apply to all requests to record filed with the PTO on or after 30 October 1999.

Currently, the PTO will record only an original document or a true copy of an original. Section 107 of TLTIA amends the Lanham Act to ease this requirement.

The Trademark Law Treaty prohibits the requirement of a statement or proof of transfer in order to record an assignment of a trademark registration. The TLTIA therefore amends the language of Section 10 of the Lanham Act to delete the clause regarding the maintenance of a "record of assignments" and to replace it with a requirement that the PTO maintain a "record of information on assignments." The Commissioner is authorized to determine what information regarding assignments will be maintained by the PTO.

New Trademark Rule 3.25 states that, in addition to the original document affecting title, the PTO will accept for recordation a copy of the document, or a copy of an extract from the document evidencing the effect on title, or a statement signed by both parties explaining how the transfer affects title. Each document submitted for recording must include a cover sheet as specified in New Rule 3.31. The cover sheet must contain the name of the conveying party, the name and

address of the receiving party, a description of the interest conveyed or transaction involved, and identification of the trademark registrations and applications involved.

In cases of merger or other circumstances, more formal documentation may still be required. As for a name change, only a legible cover sheet is required.

5. Assignment of ITU applications

The TLTIA amends Section 10 of the Lanham Act to provide that an intent-to-use application may be assigned to an entity other than the successor to the business, after the submission of an amendment to allege use under Section 1(c). This corrects an oversight in the current law, which provides for assignment of an ITU application only after the filing of the statement of use under Section 1(d).

III. Electronic Filing

Those who have visited the PTO website at www.uspto.gov are probably aware that it is currently possible to file a trademark application electronically. According to the PTO, ten percent of new applications are filed electronically,¹³ and a dramatic increase is expected in the near future. The PTO electronic filing system is called the Trademark Electronic Application System ("TEAS"). The application may be filled out and "checked for completeness" while on-line, and then may be submitted electronically (e-TEAS) or may be printed out (prinTEAS) for filing by mail.

For an application submitted electronically, payment of the filing fee is made by credit card or PTO deposit account. If the mark is used in a stylized or a design/logo form, a digitized image of the mark may be attached to the electronic application. Any specimen of use is submitted as a digitized image. Of course, the application is not "signed" in the sense of a traditional paper document. To verify the contents of the application, the appropriate person must enter any combination of alpha/numeric characters that has been specifically adopted to serve the function of the signature, preceded and followed by the forward slash (/) symbol. According to the PTO, acceptable "signatures" could include: /john doe/; /harry123/; and /123-4567/. Under e-TEAS, the proper "signatory" must actually key in the combination of characters preceded and followed by the "/" symbol that applicant has adopted as its "signature."

Once the properly-completed application is transmitted electronically, the user receives an on-screen acknowledgment of the filing, including the serial number accorded the application. An e-mail confirmation is also promptly sent by the PTO, setting forth the serial number and a summary of the application contents.

The writer is informed that, as of 30 October 1999, the electronic filing procedure was modified. The on-line form will include “blanks” corresponding to all information required for a complete application. If the user fails to fill in one of these “blanks,” the system will issue an error prompt requesting the missing information. That error prompt may be overridden, however, as to elements other than the minimum elements required for receipt of a filing date. In other words, the PTO will seek to obtain as much information as possible in the initial application. If one of the filing-date requirements is not met, the application will not be accepted and the user will receive an error message.

Rule 1.1(a)(2)(v) is being amended to state that an application may be transmitted electronically, but only on the PTO’s electronic form. New Rule 1.4(d)(1)(iii) sets forth the same electronic signature method as currently used in TEAS. In addition, this Rule requires the electronic applicant (“e-applicant”?) to print, sign and date in permanent ink, and maintain a paper copy of the electronic submission.

New Rule 1.6(a)(4) states that trademark-related correspondence transmitted electronically will be stamped with the date on which the PTO receives the transmission. This is consistent with the treatment of correspondence filed as Express Mail, and is in contrast to the treatment of documents transmitted by facsimile, which are stamped with the date of receipt, unless that date is a Saturday, Sunday, or federal holiday within the District of Columbia, in which case the date stamped will be the next day that is not a Saturday, Sunday, or federal holiday.¹⁴

With the TLIA changes to the minimum filing requirements, electronic filing may be even more attractive, since a signature is not required for filing date purposes, nor are a number of other elements of the complete application. An intent-to-use application for a block-letter mark will be particularly easy to file electronically. With just a few keystrokes and a credit card, any yahoo will be able to file a trademark application in a matter of minutes. Will this result in less work or more for the trademark practitioner? My guess is more.

Endnotes

1. For an updated list of contracting parties, surf to <http://www.wipo.org>.
2. There is inconsistency in the use of the term “application” in the Lanham Act, in the House Report on TLIA, and in the newly-promulgated Trademark Rules. Section 1 of the Lanham Act calls for the filing of “an application *and* a verified statement.” (Emphasis supplied.) The House Report speaks in terms of the “written application” and the verified statement. New Rule 2.33 states that the application “must include” a statement that is verified. In the heading for new Rule 2.32, the PTO uses the term “complete application,” which includes the verified statement.
3. See New Rule 2.34(c).

4. See New Rule 2.52.
5. The “verified statement” is a statement that is signed and verified (sworn to) or supported by a declaration under Rule 2.20 by a person properly authorized to sign on behalf of the applicant. New Rule 2.33.
6. The House Report explains at page 12 the new language of Section 1(a)(3)(B) as follows: “Rather than requiring in the verified statement a repetition of statements in the written application identifying goods and, in a section 1(a) application, dates of use, the revision requires a statement that to the best of the applicant’s knowledge and belief, the facts recited in the application are accurate.”
7. Rule 10.1 (c) defines the term “attorney” as follows: “Attorney or lawyer means an individual who is a member in good standing of the bar of any United States court or the highest court of any State. A ‘non-lawyer’ is a person who is not an attorney or lawyer.” (“Non-attorney” is not defined.)
8. This relaxed signature requirement also applies to Section 8 declarations (Amended Rule 2.161), and to statements of use, amendments to allege use, and requests for extension of time to file a statement of use (Amended Rules 2.76, 2.88, and 2.89, as corrected by the PTO in the 22 September 1999 Federal Register). The PTO correction to the latter three rules may be found at the PTO website, www.uspto.gov.
9. As justification for this reading of the Treaty, the House Report on the TLIA observes that Article 13(1)(b) of the Treaty, which concerns renewal fees, recognizes that “[f]ees associated with the furnishing of a declaration and/or evidence of use shall not be regarded as payments required for the maintenance of the registration.” But see TLT Article 13(4)(iii), which seems to point in the other direction. The House Report [No. 105-194] may be found at <http://thomas.loc.gov/>.
10. For details, see New Rule 2.185.
11. As to registrations that issued during this short period, a review of the PTO database indicates that some 1,700 registrations are involved. They issued on Tuesdays: 31 October, 7 November, or 14 November 1989. The number of renewed registrations is more difficult to determine, since some registrations whose expiration dates fell within this period were renewed for only ten years because the renewal papers were filed or processed after the expiration date. There appear to be about one hundred registrations falling in this twenty-year renewal category.
12. The writer was told by a PTO employee that the PTO contemplated requiring a tenth-year declaration for these registrations. It was considering mailing a special notice to the registrants affected. However, the PTO instead chose to interpret the statute so as to avoid this requirement. The writer finds this interpretation rather dubious, in view of the express language of amended Section 8(a), which states that a Section 8 declaration is required “for all registrations, at the end of each successive 10-year period following the date of registration.” See also Section 109 of TLIA. New Rule 2.160(a)(2) parallels the statute: “For all registrations, within the year before the end of every ten-year period after the date of registration.”
13. As of 12 September 1999, nearly nineteen thousand applications had been filed electronically in the first forty-nine weeks of fiscal 1999. Of those applications, about half were filed by corporations and forty-percent by individuals. The “attorney” portion of the electronic form was completed in about ten percent of all cases. About six hundred of the electronic applications were filed by foreign entities, half of those from either Switzerland or Canada. The leading corporate filer by far was Mattel, Inc., with four hundred fifty-one applications.
14. See current Rules 1.6(a)(3) and 1.10(a).

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The New Argentine Antitrust Act

By Juan Martín Arocena

I. Introduction

In September of 1999, the Argentine government approved a new Competition Act (Law No. 25,156). Like the former Antitrust Act, the Competition Act regulates restrictive and anti-competitive practices and abuses of dominant position. However, it also introduces a major qualitative change: the control of proposed mergers and acquisitions. Until now mergers and acquisitions were not subject to antitrust scrutiny *per se* in Argentina.

II. Transactions Regulated by the Competition Act

A. Restraint of Competition or Access to the Market and the Abuse of a Market-Dominant Position

The Competition Act prohibits any conduct or behavior, the purpose or consequence of which is to limit, restrict, misrepresent or distort competition or the access to a market. This concept includes unilateral actions as well as bilateral and multilateral actions or cartels. This may include, for instance, arrangements or agreements among companies, whether oral or written, and decisions of business associations, as well as any other kind of concerted action among competitors.

In addition, the Competition Act prohibits the abuse of a market-dominant position (so-called “monopoly power”), a concept taken from the European legislation on antitrust. The Competition Act does not *per se* prohibit the existence of a dominant position. That is, neither monopolies nor oligopolies are *per se* prohibited by the Act. However, the Act prohibits the abusive use of such dominant position; that is, provoking damaging effects on competition and the general economic interest.

A corporation has a dominant position when it is the sole supplier in the market (domestically or worldwide) or when it is not faced with substantial competition. This last criterion means that the corporation has the capacity of acting independently in the market, *i.e.*, of acting without the need to take into account competitors, suppliers or purchasers. Thus, a dominant position may be defined not only by the company’s market share, but also by other elements, such as possessing special marketing channels, know-how or unique technologies, or otherwise enjoying a significant financial advantage with respect to any other competitors.

The restraint of competition or market access and the abuse of a market-dominating position are prohibited by the Competition Act only if any detriment—actual or potential—may result to the general economic interest. The Argentine antitrust law does not proscribe any conduct “*per se*.” The Act has expressly upheld the “rule of reason” principle, which has been taken over from the U.S. antitrust jurisprudence.

Examples of prohibited practices are, among others, price fixing, manipulation and/or discrimination; restraint on production or marketing of goods; allocation of markets; discriminatory conditions; tied products; unjustified refusal to satisfy orders; and predatory pricing.

B. Control of Mergers and Acquisitions

The Competition Act also regulates transactions that involve an economic concentration of companies. The Act defines “economic concentration” as those transactions affecting on a lasting basis the control structure of the companies concerned through the merger of companies, the transfer of going concerns, the purchase of stock or other equity interests or any other agreement transferring assets or vesting the decision-making power of the relevant company. The Competition Act has adopted a broad definition of the transactions included under its umbrella.

1. Triggering Events and Thresholds

The Competition Act provides two alternative thresholds for jurisdiction. Both are based on annual sales volume. Thus the Competition Act applies if (i) the aggregate of the local sales volume of all affected companies within the country for the last fiscal year exceeds \$200 million; or (ii) the worldwide total sales volume of all affected companies for the last fiscal year exceeds \$2.5 billion. (Pursuant to the Argentine Currency Board, which functions under the Convertibility Act, one Argentine peso is equivalent to one U.S. dollar.)

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

2. Exceptions to the Authorization Rule

There are certain exceptions where, even if one of the jurisdictional criteria is met, the transaction does not have to be notified to the authorities. Those exceptions are the following.

- The acquisition of a company in which the purchaser already owns over fifty percent of the stock.
- The purchase of bonds, debentures, non-voting stock or debt securities.
- The acquisition of a single company by a single foreign company which did not previously own any assets or shares of other companies in Argentina.

- The acquisition of a wound-up company (*i.e.*, a company that recorded no activity in the country during the previous year).

3. Notification Requirements

The Competition Act changed the voluntary notification regime into a mandatory one. Failure to notify now may give rise to the imposition of fines amounting to up to \$150 million. Moreover, fines of \$1 million may be imposed per day of delay if the parties fail to notify following the expiration of the term for notice.

Any project or transaction involving an economic concentration of companies meeting the annual sales volume thresholds described above must be notified to the *Tribunal de Defensa de la Competencia* (“TDC”) prior to completion or within one week following (i) the signature of the purchase or transfer agreement or (ii) the acquisition of the controlling interest, whichever occurs first. In the case of tender offers, filings must be made within seven days after publication of the bid submitted to the Argentine Securities Commission (*Comisión Nacional de Valores*).

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

4. Procedure

There are two official forms (affidavits) for notifying the TDC, which must be completed in Spanish. The information required in the first form is about the parties, their annual sales volume and business sectors, basic features of the transaction, details of ownership and control provisions, and detailed market information. All pertinent documents are to be enclosed with the affidavit, and the notifications must be complete. The second form must be filed only if the TDC decides that it needs more information. The content of the second form may vary on a case-by-case basis.

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

Although notifications are public, the parties can request the TDC to have all or part of a notification be treated confidentially. Once the TDC has reached a final decision, its report (and not the information filed by the parties) becomes publicly available information.

5. Guidance Procedure

The Competition Act has also introduced a guidance procedure so that the companies concerned may, prior to notification, consult with the TDC on whether the thresholds are satisfied. Generally, the tendency of the TDC is to approve horizontal combinations that improve productive efficiency, and to prevent or otherwise subject to limitations

any horizontal merger that simply increases market power.

With regard to vertical mergers, the general trend of the TDC is to prevent the new economic unit from extending its market power to affect other participants in the market, *i.e.*, by increasing the costs of its competitors. Finally, as to mergers among unrelated companies (conglomerates), the goal is to prevent the use of common entrepreneurial policies, and the consequent elimination of prospective competitors. In all other cases, it is necessary to await the TDC’s future case law.

6. Time Limits

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

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

7. Final Decision

The TDC can decide to do any of the following.

- Approve the transaction.
- Approve the transaction subject to conditions which are favorable to economic and social progress such that they outweigh the negative effects on competition.
- Prevent the transaction.

Third parties may file a claim before the TDC. If the claim is dismissed, they may appeal to the *Cámara Nacional de Apelaciones en lo Penal Económico* (an appellate court). In that case, the third party can have access to non-confidential information in the TDC’s file.

8. Substantive Test

The substantive test for clearance is that a qualifying transaction (in other words, one which meets the thresholds), the purpose or effect of which is, or may be, to decrease, restrict or distort competition and the end result of which may be a detriment to the general economic interest, is prohibited. The test is set out in the Competition Act and will be used by the TDC. The analysis by the TDC must be, on the whole, made strictly on competition grounds, although the TDC is expressly allowed to consult with the relevant consumer associations and to consider the international competitiveness of the “national” industry.

9. Penalties

The TDC may order the parties to cease any prohibited conduct, and may impose any fine, which may range between ten thousand and one hundred and fifty million

pesos. Any director, manager, administrator, syndic or member of the audit committee, any agent or legal representative who, due to his or her action or inaction has contributed to the violation, may be found jointly liable for the payment of fines.

In respect of any consummated acts in violation of the Act, the TDC may demand from the competent judge that the relevant violating company be either dissolved, wound-up, de-merged or broken-up.

10. Appeals

The TDC's decision can be challenged, within fifteen business days after it is issued, to the *Cámara Nacional de Apelaciones en lo Penal Económico*.

C. Relevant Authorities

The TDC is the Argentine competition authority; it operates under the authority of the Ministry of Economy and Public Works and Services. In addition, the Competition Act has granted the TDC exclusive authority to enforce the antitrust law within the sphere of the public administration. The TDC has broad powers to, *inter alia*, hold hearings, demand reports from any involved parties or, if it deems necessary, summon persons or parties to public hearings or conduct the review of documents. However, the TDC must obtain a judicial warrant to do any search of premises with the purpose of conducting any inspections (unless the occupants of the premises consent to the search), or to impose injunctive measures. The TDC has six members and a chairman, who are recommended by an *ad hoc* committee and appointed by the government for a term of six years.

III. The American and Argentinean Antitrust Law

The Sherman Act and the Clayton Act of the U.S. on the one hand and the Argentine Competition Act on the other hand have, among others, the following similarities and differences:

A. Similarities

- *Prenotification*. Both Acts require a prenotification of certain mergers and acquisitions to the respective regulatory body.
- *Exceptions*. The exceptions to the obligation of notifying a merger are similar in both Acts, although the U.S. Act has set forth more exceptions than the Argentine Competition Act.
- *Guidelines*. The TDC has established the same guidelines as those used by the U.S. Department of Justice and the U.S. Federal Trade Commission for horizontal mergers.

B. Differences

U.S. Law has established a much more severe control of mergers through the concept of "*per se* infractions," which

state that when certain courses of conduct have been shown (*e.g.*, an agreement to establish a product price), it is unnecessary to continue the investigation in order to punish the parties, because it is conclusively presumed that such courses of conduct are always harmful to the economy. In the Argentinean Act, on the other hand, it is imperative to analyze the overall effect of those courses of conduct on the economy and competition, since some transactions that may, at first glance, appear to be anticompetitive may in fact be beneficial to the economy as a whole.

IV. Basis of In Personam Jurisdiction: Corporate Presence and Doing Business in Argentina

A common question raised by non-Argentine companies is whether they might be subject to the Argentine Competition Act if they merge with or acquire a non-Argentine company, and one or both companies involved have activities in Argentina.

A sure basis for in personam jurisdiction under the Competition Act is the corporate presence in Argentina of any of the companies involved in the merger or acquisition, either through a subsidiary or a branch. That notwithstanding, case law may conclude in the future that forms of "doing business" other than mere corporate presence (such as having a franchisor or a distributor in Argentina) make an entity amenable to the jurisdiction of Argentine Competition Act. In the meantime, mergers of non-Argentine companies—without a corporate presence in Argentina—that perform business activities in the country should be carefully analyzed on a case-by-case basis.

V. Conclusion

The reforms are generally welcome, since the previous system did not function adequately, which resulted in few transactions being investigated by the Argentine competition authorities: only thirty-two transactions in 1998; thirty-five transactions in 1997; and one hundred seventy-two transactions in the entire period between 1981 and 1996.

The reforms make the procedure more transparent, and the express reference in the Competition Act to a "guidance" procedure before the TDC is also welcome.

The last minute veto of "market share" as one of the alternative thresholds for jurisdiction in a compulsory notification regime is in line with most European merger control regimes, under which market share thresholds are rarely used or have recently been discontinued, primarily due to the difficulty in defining market share and the resulting legal uncertainty which it creates.

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APPENDIX

Guidelines of the TDC

Past Mergers in Argentina that should have been notified

In order to serve exclusively as a guideline for the future, the TDC analyzed in a memorandum which of the mergers and acquisitions that took place in 1996 and 1997 would have had to be notified under the Competition Act, had the Act been in force at the time.

For that purpose the TDC classified economic concentrations in five classes of transactions: vertical mergers; horizontal mergers; market extensions; product extensions; and holdings.

Horizontal Mergers: A company or group of companies acquire a company that produces and sells the same product in the same geographical area.

Vertical Mergers: A company or group of companies acquires a company located in the chain of commercialization of the product.

Product Extensions: Transactions between companies selling products that are not competitive between themselves but that use similar marketing or production channels.

Market Extensions: Transactions between companies that produce similar products but sell them in different geographical areas.

Holdings: Transactions between companies that do not have a clear economic relationship (e.g., a construction company acquiring a petrochemical one).

1. Main mergers and acquisitions—Argentina 1996

Transactions	> \$15 million	< \$15 million	No data	Total
Horizontal	21	4	13	38
Vertical	6	2	2	10
Market extension	19	9	12	40
Product extension	1	2	3	6
Holdings	15	9	10	34
Total	62	26	40	128

The chart shows that the vast majority of the transactions that took place in Argentina in 1996 can be placed in three categories: horizontal mergers; market extensions; and holdings.

2. Transactions that would have been subject to authorization of the TDC—Argentina 1996.

If the Competition Act had been in force at the time these mergers took place, at least twelve of them would have needed TDC approval. These are the following.

Acquiror	Target	Interest	Price (in mill)	Activity	Transaction
Orígenes S.A.	Activa – Anticipar S.A.	100 %	100	Retirement and Pension Funds	Horizontal
Clorox S.A.	Poett S.A.	100%	95	Home Products	Horizontal
Solvay	Derivados Petroquímicos	70%	91	Petrochemical	Vertical
Polisur (Dow Chemical)	Petropol	100%	88	Chemical	Horizontal
Molinos S.A.	Granja del Sol	100%	61	Food Industry	Horizontal
Coca Cola Femesa Bs.As.	San Isidro Refrescos	100%	56	Beverage	Horizontal
Ford Motor Argentina	Sistemaire S.A.	60%	45	Automobile	Vertical
Terrabusi S.A.	Mayco-Capri S.A.	100%	35	Food Industry	Horizontal
Quilmes S.A.	Cervecerías Bieckert	85%	34	Beverage	Horizontal
Aluar S.A.	C& K Aluminio S.A.	50%	23	Metal Industry	Vertical
Multicanal S.A.	Supercanal S.A.	20%	18	Media (Cable TV)	Vertical
Molinos S.A.	Molino Nuevo S.A.	100%	16	Food Industry	Horizontal

All these transactions share two elements: (i) the acquirors had a significant annual sales volume; and (ii) their purpose was to increase product efficiency or the reinforcement of market power. The majority of said transactions were horizontal mergers and almost all of them involved the acquisition of one hundred percent of the shares of the target.

3. Transactions subject to authorization of the TDC–Argentina, First Half of 1997.

Like in 1996, most of the mergers and acquisitions in 1997 were horizontal and the acquiror in most cases bought one hundred percent of the shares of the target. The charts indicate that most of the transactions took place in the food, petrochemical and media industries.

Acquiror	Target	Interest	Price (in mill)	Activity	Transaction
CEI	Cablevision	64%	480	Media (Cable TV)	Horizontal
Banco Francés	Banco Crédito Argentino	71.75%	446	Banking	Horizontal
Repsol	EG3	60%	400	Petrochemical	Horizontal
Astra	Pluspetrol	45%	360	Petrochemical	Vertical
Daewoo	Philco	50%	100	Electronics	Horizontal
Arcor	Lía	100%	90	Food Industry	Horizontal
Multicanal	Río de la Plata Cable Color	100%	83	Media (Cable TV)	Horizontal
Repsol	Algas & others	100%	75	Petrochemical	Vertical
Disco	Su Supermercado	100%	72	Supermarkets	Horizontal
Siderar	Comesi	100%	65	Steel	Horizontal
Skytel	Radiomensaje	100%	32	Telecommunications	Horizontal
Máxima AFJP	Patrimonio AFJP	100%	26	Pension and Retirement Funds	Horizontal

Extraterritorial Application of U.S. Labor and Employment Laws

By Aaron J. Schindel

I. Introduction

The Supreme Court has long recognized that Congress has the power to regulate the overseas activities of domestic United States corporations and citizens.¹ The Court has also declared, however, that it will interpret labor and employment statutes to apply solely within the territorial jurisdiction of the United States unless Congress has stated clearly its intention to regulate beyond the national boundaries.² This principle is designed to “protect against unintended clashes between our laws and those of other nations.”³ Labor and employment laws from the New Deal era lacked that intent, and have been interpreted to apply only within the United States, but more recent legislation has become explicitly extraterritorial.

II. Laws Lacking Extraterritorial Application

A. National Labor Relations Act of 1935 (“NLRA”)⁴

Applying its guiding principle, the Supreme Court has held that a number of U.S. labor and employment laws do not apply outside the United States. Among the most significant of these is the NLRA, which establishes the right of employees to form unions and otherwise engage in concerted activity for mutual aid and protection, and requires employers to bargain with the duly authorized collective bargaining representative.⁵

B. Fair Labor Standards Act of 1938 (“FLSA”)⁶

The FLSA is another piece of New Deal legislation, establishing the minimum wage and mandating payment of time-and-a-half for work over forty hours in a work week. Finding insufficient evidence of a Congressional intent to apply the law to work performed outside the United States and its territories, the Supreme Court has held that the statute is inapplicable to such employment.⁷

C. Equal Pay Act (“EPA”)⁸

The EPA requires that women receive equal pay for equal work. It was adopted as an amendment to the FLSA and thus must follow that statute’s enforcement scheme.

D. Worker Adjustment and Retraining Notification Act (“WARN”)⁹

The WARN Act requires employers in certain circumstances to provide advance notification to employees of a plant closing or a mass layoff. The WARN

statute contains no reference to extraterritorial application. The Department of Labor regulations and guidelines specify, however, that foreign work sites are not covered by the statute.¹⁰

E. Family and Medical Leave Act (“FMLA”)¹¹

The FMLA, which went into effect in 1993, requires employers to provide employees with unpaid leave from work if certain specified conditions are satisfied. Although there is no case law interpreting the scope of its applicability outside of the U.S., the FMLA was patterned in many respects after the FLSA, which excludes from coverage U.S. citizens working in foreign countries. In addition, the preamble to the Department of Labor regulations states that the WARN “work site” definition will be adopted in determining whether the employer has enough employees to trigger coverage under the statute (fifty employees within seventy-five miles of the work site). As noted above, the WARN definition excludes foreign work sites from coverage. Thus, while the issue is not free of doubt, it does not appear that the FMLA would apply to U.S. citizens employed in foreign countries.

F. Occupational Safety and Health Act (“OSHA”)¹²

The OSHA statute requires employers to adhere to certain safety standards in the workplace. The statute contains a specific provision pertaining to its geographic scope: The reach of the statute is limited to “employment performed in a workplace in a State, the District of Columbia, The Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, Guam, The Trust Territory of the Pacific Islands, Lake Island, Outer Continental Shelflands . . . Johnston Island, and the Canal Zone.”¹³ OSHA, therefore, does not apply to U.S. citizens working in foreign countries.

G. The Employee Retirement Income Security Act (“ERISA”)¹⁴

ERISA governs the provision of pension and welfare benefits (*e.g.*, health benefits) to employees. Employee benefit plans are subject to ERISA if they are established or maintained “by any employer engaged in commerce or in any industry or activity affecting commerce.”¹⁵ The statute explicitly excludes from coverage employee benefit plans that are “maintained outside of the United States¹⁶ primarily for the benefit of individuals substantially all of whom are nonresident aliens.”¹⁷ There is little published guidance construing and applying this exclusion; and neither the Department of Labor nor the courts have developed any clear test to deter-

mine whether a plan is maintained “primarily for the benefit of nonresident aliens.”

III. Laws Having Extraterritorial Application

A. Title VII of the Civil Rights Act of 1964 (“Title VII”)¹⁸

After the Supreme Court declared that Title VII did not apply to U.S. citizens working abroad for U.S. employers,¹⁹ Congress amended the statutory definition of “employee” to include, “[w]ith respect to employment in a foreign country, . . . an individual who is a citizen of the United States.”²⁰ Foreign nationals working outside of the United States, however, are not protected under Title VII, whether they work for American or for foreign employers.²¹

Congress further amended the law to expressly make it applicable to the foreign operations of American companies, to the extent that the American company controls the foreign entity.²² The determination of whether the American company controls the foreign corporation is to be based on four factors: “(A) the interrelation of operations; (B) the common management; (C) the centralized control of labor relations; and (D) the common ownership or financial control, of the employer and the corporation.”²³

In 1993, the Equal Employment Opportunity Commission issued a guidance memorandum explaining how, in light of the amendments, the agency will enforce Title VII and the Americans with Disabilities Act overseas.²⁴ The test for determining the nationality of employers is not explicitly laid out in the statute or its legislative history. The first point of inquiry in ascertaining an employer’s nationality should be the company’s place of incorporation. An employer incorporated in the United States will typically be considered to be an American employer, since an entity that chooses to enjoy the benefits of being incorporated in a country must also take on the concomitant obligations. For the most part, therefore, the nationality of an entity will be relatively easy to discern.²⁵

Nonetheless, the EEOC states that, at times, it may be necessary to examine factors other than the discriminating entity’s place of incorporation. In particular, other factors will have to be considered to assess the “nationality of those entities (such as law firms or accounting partnerships) that are ‘employers’ or other covered entities within the meaning of Title VII, but that are not incorporated companies.”²⁶ Additionally, where the employer is incorporated outside the United States but has numerous contacts here, the totality of the company’s contacts with the United States must be assessed to make a nationality determination.²⁷

Potentially relevant factors to this inquiry include, but are not limited to: (a) the company’s principal place of business, *i.e.*, the place where primary factories, offices, or other facilities are located; (b) the nationality of dominant shareholders and/or those holding voting control; and (c) the nationality and location of management, *i.e.*, of the officers and directors of the company. Additionally, a company may be found to be American if the factors stated above suggest a significant connection to the United States. The analysis must be performed on a case-by-case basis, and no one factor is determinative. It should be noted that the named respondent must qualify as an “employer” or an otherwise covered entity within the meaning of the relevant statute.²⁸

The Commission pointed to the discussion in *Lavrov v. NCR Corp.*²⁹ that pertains to the integrated enterprise concept in the context of a Title VII claim against a foreign subsidiary or an American parent. Looking at the four factors set out in the statute, the court held that there was sufficient evidence of the possible interrelationship of the American parent and its foreign subsidiary. The court found that the foreign entity, which was a wholly-owned subsidiary of the American company, shared common ownership with it.³⁰ Furthermore, the court was influenced by the fact that the American company instituted corporation-wide personnel policies; that certain personnel decisions with regard to individual employees required approval by the American company; and that the foreign subsidiary was not authorized to change any remuneration plans, benefits, or operating conditions without prior approval of its American parent. The court also noted the American company’s appointment of management members of the foreign subsidiary’s board, and the foreign company’s function in market products assigned by the American company. These factors were held to be relevant to assessing the commonality of management and the interrelationship of operations of the two companies.³¹

Importantly, the *Lavrov* court stated that it is not necessary to have all four criteria for assessing integrated status be present in every case, and that the presence of any single factor in the Title VII context is not conclusive.³² The final determination must depend on the facts of each case.

The EEOC’s memo also highlighted the fact that the statute states that it shall not be unlawful under Title VII for an employer to engage in otherwise prohibited conduct if compliance would cause an employer to violate the law of the foreign country in which the workplace is located.³³ The Commission acknowledged some uncertainty surrounding the definition of what constitutes a law within the parameters of this defense.³⁴

B. Americans with Disabilities Act of 1990 (“ADA”)³⁵

The ADA prohibits discrimination against the disabled, and requires reasonable accommodation to enable a qualified individual with a disability to perform the essential functions of the job he holds or seeks. The statute was amended in 1991 along with Title VII to make clear that it applies to United States citizens working in a foreign country for an American employer or a foreign corporation that is controlled by an American employer.³⁶ The principles discussed above concerning Title VII also apply therefore to the ADA.

C. Age Discrimination in Employment Act (“ADEA”)³⁷

The ADEA prohibits discrimination against employees over age forty on the basis of their age. In 1984, Congress amended the ADEA to give it a limited extraterritorial reach. Using substantially the same language as was later incorporated into Title VII and the ADA, the ADEA applies overseas only when the employee is American citizen, and the employer is an American company or is a foreign corporation controlled by an American company.³⁸ Noncitizens working outside the United States are not included in the reach of the ADEA, nor are American citizens working abroad for companies not controlled by American companies.³⁹ Additionally, an American employer who controls a corporation whose place of incorporation is in a foreign country is responsible for any prohibited conduct engaged in by the foreign employer. Thus, U.S. companies cannot circumvent the ADEA by employing American workers through foreign subsidiaries.⁴⁰

Foreign corporations that are not controlled by an American company are not subject to the prohibitions of the ADEA, since the statute provides only that the definition of an employee, for the purposes of the ADEA, includes any individual who is citizen of United States who is employed by an American employer or an American-controlled corporation in a workplace in a foreign country, and does not include foreign corporations not controlled by American employers.⁴¹

In *Mas Marques v. Digital Equip. Corp.*,⁴² the court refused the plaintiff’s claim to recover under the ADEA because Digital did not sufficiently control its foreign subsidiary. Mas Marques, a U.S. citizen, was employed in West Germany at the time of the suit. He claimed that Digital Equipment GmbH (Digital GmbH), a West German corporation, and its parent, Digital Equipment Corporation (Digital), a U.S. corporation, discriminated against him on the basis of age, sex, and national origin.

The court denied the claim by first noting that Digital Equipment International governed the personnel policies at Digital GmbH without any input from Digital Equipment Corporation.⁴³ Second, the court found that the two organizations maintained “separate corporate structures, with independent business records, bank accounts, tax returns, financial statements and budgets.”⁴⁴ Finally, the two employers had different marketing strategies and sales goals.⁴⁵ Thus, the court concluded that the entities were sufficiently separate and refused to apply the ADEA abroad.⁴⁶

Just like the amendments extending the reach of Title VII and the ADA, the 1984 amendments also establish that the company need not comply with the ADEA if to do so would violate the laws of the country in which it operates.⁴⁷ Thus, in *Mahoney v. RFE/RL, Inc.*,⁴⁸ the court held that an American corporation operating in Germany did not violate the ADEA by terminating an American citizen due to his age, when its union contract required the employees to retire at age sixty-five. The court stated that “RFE/RL’s collective bargaining agreement is legally enforceable, which necessarily means that breaching the agreement in order to comply with the Act would, in the language of § 623(f)(1), ‘cause’ RFE/RL ‘to violate the laws of’ Germany.”⁴⁹ It should be noted that there is some ambiguity as to what constitutes “laws of a foreign country” which cannot be superseded by American anti-discrimination laws. The defendant in *Mahoney* made several attempts to exclude the American workers from the union contract or to renegotiate the offending provisions. However, those attempts failed. The court relied on the fact that there was no indication that RFL/RL entered into the contract in question to avoid the reach of the ADEA.⁵⁰

IV. New York Human Rights Law⁵¹

The New York State Human Rights Law prohibits discrimination on various grounds, including age, color, creed, disability, marital status, national origin, race, religion and sex. Extraterritorial application of the law was denied in *Hammel v. Banque Paribas*.⁵² The court recognized that the language of the statute could be read broadly to allow for extraterritorial application, but the court relied on the Supreme Court’s reasoning in *EEOC v. Arabian American Oil Co.*, rejecting extraterritorial application in the absence of a clearly stated intention to have the law apply outside the state’s borders.

Additionally, the New York Human Rights Law does not provide a non-resident with a private cause of action for discriminatory conduct committed outside of New York by a New York corporation.⁵³

Endnotes

1. "Congress has the authority to enforce its laws beyond the territorial boundaries of the United States." *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991), citing *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 284-285 (1949); and *Benz v. Compania Naviera Hidalgo, S.A.*, 353 U.S. 138, 147 (1957).
2. "It is a longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'" *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991), quoting *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 284-285 (1949).
3. *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991), citing *McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10, 20-22 (1963).
4. 29 U.S.C. §§ 151 *et seq.*
5. See *McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10 (1963) (National Labor Relations Act does not apply to employees of Honduran flag vessel, even though vessel is part of a fleet ultimately owned by a U.S. company and regularly travels to the United States).
6. 29 U.S.C. §§ 201 *et seq.*
7. See *Foley Bros., Inc. v. Filardo*, 336 U.S. 281 (1949) (employee on a federal project in Iran was denied recovery in an action for over-time pay because the Fair Labor Standards Act, by its language, is limited to the U.S.).
8. 29 U.S.C. § 206(d).
9. 29 U.S.C. §§ 2101 *et seq.*
10. 29 C.F.R. § 639.i(n).
11. 29 U.S.C. §§ 2601 *et seq.*
12. 29 U.S.C. §§ 651 *et seq.*
13. 29 U.S.C. §§ 653 *et seq.*
14. 29 U.S.C. §§ 1001 *et seq.*
15. 29 U.S.C. § 1003(a)(1).
16. The United States is defined to include the fifty states, the Outer Continental Shelf Lands (defined in the Outer Continental Shelf Lands Act), Puerto Rico, the Virgin Islands, American Samoa, Guam, Wake Island and the Canal Zone. 29 U.S.C. § 10002(10).
17. 29 U.S.C. § 1003(b)(4).
18. Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e *et seq.*, prohibits discrimination in employment on the basis of race, color, creed, religion or sex.
19. *EEOC v. Arabian American Oil Co.*, 499 U.S. 244 (1991).
20. 42 U.S.C. § 2000e(f).
21. The statute provides that Title VII "shall not apply to an employer with respect to the employment of aliens outside any State . . .," 42 U.S.C. § 2000e-1(a), and "shall not apply with respect to the foreign operations of an employer that is a foreign person not controlled by an American employer." 42 U.S.C. § 2000e-1(c)(2).
22. "If an employer controls a corporation whose place of incorporation is a foreign country, any practice prohibited by [Title VII] engaged in by such corporation shall be presumed to be engaged in by such employer." 42 U.S.C. § 2000e-1(c)(1).
23. 42 U.S.C. § 2000e-1(c)(3).
24. EEOC, Guidance on Application of Title VII Overseas (1993).
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.*
29. 600 F. Supp. 923 (S.D. Ohio 1984).
30. 600 F. Supp. at 928.
31. *Id.*
32. 600 F. Supp. at 927.
33. "It shall not be unlawful . . . for an employer (or a corporation controlled by an employer) . . . to take any action otherwise prohibited by [Title VII] with respect to an employee in a workplace in a foreign country if compliance with such section would cause such employer (or such corporation) . . . to violate the law of the foreign country in which such workplace is located." 42 U.S.C. § 2000e-1(b).
34. The memo pointed to *Mahoney v. RFE/RL, Inc.*, 818 F. Supp. 1 (D.D.C. 1992), as an example of the proper application of the defense. However, that decision has been overruled by *Mahoney v. RFE/RL, Inc.*, 47 F.3d 447 (D.C. Cir. 1995). *Mahoney* dealt with the applicability of the Age Discrimination in Employment Act ("ADEA") in Germany and is discussed more extensively *infra*.
35. 42 U.S.C. §§ 12101 *et seq.*
36. 42 U.S.C. §§ 12111(4), 12112(c).
37. 29 U.S.C. §§ 621 *et seq.*
38. 29 U.S.C. §§ 623(h), 630(f).
39. See *Denty v. SmithKline Beecham Corp.*, 69 FEP Cas. (BNA) 376 (E. D. Pa, 1995) (denying coverage where plaintiff was employed in the United States by a wholly-owned subsidiary of a British parent and complained that he had been denied positions with the parent abroad because of his age), *aff'd*, 109 F.3d 147 (3d Cir. 1997), *cert. denied*, 118 S.Ct. 74 (1997).
40. See *EEOC v. Kloster Cruise, Inc.*, 888 F. Supp 147 (S.D. Fla. 1995).
41. *Robinson v. Overseas Military Sales Corp.*, 62 FEP Cas. (BNA) 759 (E.D.N.Y. 1993).
42. 490 F. Supp. 56 (D. Mass. 1980).
43. *Id.* at 58.
44. *Id.*
45. *Id.*
46. *Id.* at 56. It must be noted that the case was decided prior to the 1984 amendment, which expressly granted ADEA rights to American citizens working abroad for American-controlled companies. However, the court's analysis of the "control" issue exactly mirrors the four-factored test that was later expressly incorporated in the statute. Robertson, *Note: Has the Age Discrimination in Employment Act Remained Effective in the United States as Well as Abroad in an Increasingly Globalized Economy?*, 6 Elder L.J. 323 (1998).
47. 29 U.S.C. § 623(f)(1).
48. 47 F.3d 447 (D.C. Cir. 1995).
49. 47 F.3d at 450.
50. *Id.*
51. N.Y. Exec. L. §§ 290 *et seq.*
52. 780 F. Supp. 196, 199-200 (S.D.N.Y. 1991).
53. *Thomas v. Texaco, Inc.*, 998 F. Supp. 368, 371 (S.D.N.Y. 1998), citing *Beckett v. Prudential Ins. Co. of America*, 893 F. Supp. 234, 238 (S.D.N.Y. 1995).

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