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THE ORCHID PROBLEM:

Litigation versus Arbitration in the Americas—Advantages and Disadvantages

Editor's Note: On 18 October 2001, at the Annual Fall Meeting of the International Law and Practice Section of the NYSBA, held this year in Rio de Janeiro, Helena Tavares Erickson of the Section chaired a panel discussion on the relative advantages and disadvantages of utilizing either litigation or arbitration to resolve disputes among parties from various North American and South American countries. Panelists from various countries in the Americas contributed to the discussion about which dispute resolution method would be preferable in their particular home country.

The focus of the panel discussion was an analysis of litigation and arbitration in the context of the fact pattern set forth below, called "The Orchid Problem." Consequently each participant commented on the relative desirability of litigation or arbitration in the context of resolving the disputes described in the fact pattern below.

We present here a number of the papers prepared by various participants on the panel to supplement their remarks during the panel discussion.

The Orchid Problem

Orchid Industries Inc. ("Orchid"), a New York biotech company originally formed by two stay-at-home moms in Park Slope, Brooklyn, with its principal place of business in Hawaii, has developed a hybrid orchid that is going to dominate every flower show once it is globally marketed. Because it has run out of growing space at its plantation on Lanai, Orchid is contemplating entering into contracts with several Latin American growers; namely, Flores Brasileiras Ltda. ("Flores"), a Brazilian company; Aureliano Rosa y Associados ("Rose"), a Mexican partnership; Plantas de Colombia S.A. ("Plantas"), a Colombian limited liability company, fifty-one percent of which is owned by the Colombian government; and Jardins de Buenos Aires ("Jardins"), an Argentinian limited liability company.

Orchid is using its standard form grower's contract, whereby it licenses its technology to the grower in exchange for fifty percent of any profits made. All of its previous grower's contracts (mainly with California companies) have been governed by New York law and contained an arbitration clause providing that:

> Any and all disputes arising out of or relating to this Agreement shall be finally settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitration shall take place in San Francisco, California.

The closings for each contract are to take place tomorrow and Daisy Forsynth of Violet, Lily & Rosenblum, outside counsel for Orchid and your friend from your days in the U.S., has sent you an e-mail asking, "Would this clause, with a change to arbitration in New York, and the New York governing law clause be upheld in your country? Should we have the arbitration take place locally? Would it be better to require the grower to submit to the jurisdiction of the New York courts? If the growers insist, should our client submit to your jurisdiction?"

Daisy was at the gym when you attempted to call her back, but your research has uncovered the following facts.

Flores is a small closely held company which, as far as you can tell, has never done any business outside Brazil. Rose supplies several florists in San Diego, California, but does not appear to have any assets outside Mexico. Plantas is a huge conglomerate with offices all over Latin America and a marketing office in New York. Jardins apparently does a fair amount of business in Europe but provides that all of its contracts be paid in U.S. dollars, and for that reason maintains an account at Citibank in Manhattan.

What do you advise and why?

Litigation versus Arbitration in the Americas: Advantages and Disadvantages from a New York Perspective

By Helena Tavares Erickson

I. Introduction: Proposed Arbitration Provision

The Orchid Problem presents the typical last-minute consultation with respect to a dispute resolution clause that requires the advocate to weigh the advantages of litigation versus arbitration, here with entities based in Latin America. The proposed arbitration clause provides:

> Any and all disputes arising out of or relating to this Agreement shall be finally settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitration shall take place in San Francisco, California.

The clause is proposed to be entered into by Orchid Industries, Inc. ("Orchid"), a New York company with its principal place of business in Hawaii; Flores Brasileiras Ltda. ("Flores"), a Brazilian company; Aureliano Rosa y Associados ("Rosa"), a Mexican partnership; Plantas de Colombia S.A. ("Plantas"), a Colombian limited liability company owned fifty-one percent by the Colombian state; and Jardins de Buenos Aires ("Jardins"), an Argentinian limited liability company.

This paper discusses the law applicable to such a clause, the implications, if any, of a change in the place of arbitration to New York and possible advantages of advocating instead that the parties submit to the jurisdiction of New York or foreign courts.

II. Sources of Arbitration Law

A. Arbitration in the United States

The advantages of arbitration over litigation as a method of dispute resolution have been widely recognized.[1] Arbitration is considered preferable because it is seen as a process that combines finality of decision with speed, low expense, and flexibility in the selection of the principles to be used in solving a problem.[2] However, for many years American courts were opposed to arbitration due to the fact that in "ancient times" English courts fervently opposed anything that would deprive them of their jurisdiction.[3]

In 1925, Congress passed the Federal Arbitration Act (FAA), modeled on the New York Arbitration Act enacted in 1920, to overcome the anti-arbitration rule of many of the United States courts.[4] The FAA now has three chapters. The first governs domestic arbitration agreements involving interstate commerce.[5] The second chapter contains the implementing legislation for the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention").[6] Finally, the third chapter contains the implementing legislation for the Inter-American Convention on International Commercial Arbitration ("Inter-American Convention").[7]

B. The Federal Arbitration Act

The FAA provides at 9 U.S.C. § 2 that arbitration agreements falling within its scope are "valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." Parties to an arbitration agreement may, pursuant to §§ 4 and 5 of the FAA, petition a court within the district in which arbitration is sought to compel arbitration or to appoint an arbitrator if one has not been designated. "As a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."[8] Furthermore, enforcement of the award may be sought either in the district where the award was made or in any other district proper under the general venue laws.[9] While it is possible to overturn or vacate an arbitration award, the grounds for doing so, as will be discussed below, are extremely limited.[10] Finally, the FAA requires a court to stay litigation that is commenced in violation of a valid arbitration agreement.[11]

C. New York Convention

The New York Convention governs non-domestic arbitration agreements. In the United States, an arbitration agreement is considered non-domestic if (i) it involves a party domiciled abroad or a party with a principal place of business abroad, (ii) the agreement envisages performance or enforcement abroad, or (iii) the agreement has some other reasonable relation with a foreign state.[12] The New York Convention reflects a policy favoring arbitration in the context of international business:

> Enforcement of international arbitral agreements promotes the smooth flow of international transactions by remov-

> ing the threats and uncertainty of time-consuming and expensive litigation. The parties may agree in advance as to how their disputes will be expeditiously and inexpensively resolved should their business relationship sour. This treaty [. . .] makes it clear that the liberal federal arbitration policy "applies with special force in the field of international commerce."[13]

All of the parties to our proposed arbitration agreement, except Flores (of Brazil), reside in countries that are parties to the New York Convention.

D. The Inter-American Convention

Article 1 of the Inter-American Convention provides that, "An agreement in which the parties undertake to submit to arbitral decision any differences that may arise or have arisen between them with respect to a commercial transaction is valid."[14]

The United States became a party to the Inter-American Convention in 1975 and Congress enacted implementing legislation in 1990, codified as Chapter 3 of the FAA.[15] Pursuant to 9 U.S.C. § 304, the enforcement of awards rendered in states party to the Convention is based on reciprocity. Where the parties meet the requirements for application of the New York Convention *and* the Inter-American Convention, the statute states that, "If a majority of the parties to the arbitration agreement are citizens of a State or States that have ratified or acceded to the Inter-American Convention and are member States of the Organization of American States, the Inter-American Convention shall apply."[16] All the parties to our proposed arbitration agreement are parties to the Inter-American Convention. Furthermore, all the parties to the proposed arbitration agreement are members of the Organization of American States. The Inter-American Convention will therefore govern the arbitration agreement as to each of the proposed parties.

The implementing statute for the Inter-American Convention states that §§ 202–205 and 207 of the FAA are to be incorporated into Chapter 3 by reference, "except that for the purposes of this chapter 'the Convention' shall mean the Inter-American Convention."[17]

III. Various Aspects of the Arbitration

A. Statutory Requirements to Compel Arbitration

Under Chapter 3 of the FAA, the district courts of the United States have original jurisdiction over actions falling under the Inter-American Convention for the purposes of compelling arbitration and confirming arbitral awards.[18] Furthermore, the same provisions of the statute provide that the district courts have original jurisdiction without regard to the amount in controversy. Once a written agreement is found to exist, three basic requirements must be met for a district court to find that an agreement falls under the Inter-American Convention: it "(1) must arise out of a legal relationship (2) which is commercial in nature and (3) which is not entirely domestic in scope."[19]

Here, the contemplated agreement involves a legal relationship, although this requirement rarely is an issue. Commerce has been defined by the FAA as "commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation."[20] Since we are dealing here with commerce between a State and foreign nations, our arbitration agreement will satisfy the commerce requirement.

The requirement that an award be not entirely domestic "denotes awards which are subject to the Convention not because made abroad, but because made within the legal framework of another country, *e.g.*, pronounced in accordance with foreign law or involving parties domiciled or having their principal place of business outside the enforcing jurisdiction."[21] Any award granted in accordance with our proposed arbitration provision would qualify as not entirely domestic since all the parties to the agreement other than Orchid are domiciled outside the United States—the chosen forum—and have their principal place of business outside the United States where the subject of the contract will be performed.[22] If the parties were domiciled in non-signatory countries, the fact that arbitration is to take place in the U.S. would suffice to bring this dispute within the Convention.[23]

B. Choice of Law and Venue Issues

While much of the case law related to choice of law and similar issues has arisen in the context of the New York Convention, it would likely also be applicable to cases arising under the Inter-American Convention, since they are "intended to achieve the same results, and their key provisions adopt the same standards, phrased in the legal style appropriate for each organization."[24] It was the expectation of the House of Representatives Committee that "the courts in the United States would achieve a general uniformity of results under the two conventions."[25]

1. Changing the Arbitration Venue to New York

Federal policy strongly favors arbitration as an alternative dispute resolution process.

> The policy in favor of arbitration is even stronger in the context of interna-

> tional business transactions. Enforcement of international arbitral agreements promotes the smooth flow of international transactions by removing the threats and uncertainty of time-consuming and expensive litigation. The parties may agree in advance as to how their disputes will be expeditiously and inexpensively resolved should their business relationship sour.[26]

Federal courts enforce agreements to arbitrate in accordance with the intent of the parties.[27] These considerations have led courts to give parties to an arbitration agreement significant leeway in determining the course of how their dispute will be resolved. Choosing either California or New York as the venue for arbitration will therefore present no difficulties, regardless of whether any of the parties has any contacts with the state. Furthermore, courts of the United States would have personal jurisdiction over the foreign parties to compel arbitration in New York or California because of the parties' agreement to arbitrate in New York.[28] "By agreeing to arbitrate in New York, where the United States Arbitration Act makes such agreements specifically enforceable, the [party] must be deemed to have consented to the jurisdiction of the court that could compel the arbitration proceeding in New York. To hold otherwise would be to render the arbitration clause a nullity."[29]

Accordingly, whether to choose a California or New York venue may be largely a question of which jurisdiction might prove more expeditious for the enforcement of an eventual award. Moreover, while this discussion focuses on federal law under the assumption that the parties would prefer a federal venue, there is no reason that the parties could not seek to compel arbitration, enforce an award or engage in other ancillary litigation in state court if they otherwise meet the jurisdictional requirements of such courts.[30]

2. Applying New York Law

Here the contract is to be governed by New York law. "The thrust of the federal law is that arbitration is strictly a matter of contract, the parties to an arbitration agreement should be at liberty to choose the terms under which they will arbitrate."[31] This presumption is even stronger in the context of international arbitration, as is evidenced by the broad language of the Inter-American Convention. Orchid should therefore have no problem enforcing an arbitration agreement where the contract chooses the laws of the State of New York,[32] notwithstanding that performance of the substantive contract will be in Latin America. However, in order to avoid a potential argument that by choosing a California venue, the parties intended to apply California arbitration law, the clause should be amended to provide that the arbitrators are to apply the laws of the State of New York.[33]

The arbitration procedure itself will likely be governed by the FAA. In general, the FAA pre-empts state laws which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."[34] However, the FAA does not require that its own rules be applied when the parties have affirmatively agreed to arbitrate under a different set of rules. This policy has given rise to uncertainty as courts attempt to determine if the parties intended by a standard choice of law clause to incorporate specific state laws respecting arbitration into their agreement. Thus, it has been argued that a choice of New York law is meant to also be a choice of New York's arbitration law and not the FAA.[35] It is recommended that, if the parties wish state arbitration law to apply, they add a clause so stating.

Regardless of where Orchid ultimately chooses to arbitrate, the question of arbitrability is generally an issue for the courts.[36] However, if the parties decide that they would like the issue decided by the arbitrator they may (and must) explicitly say so. "In this manner the law treats silence or ambiguity about the question 'who (primarily) should decide arbitrability' differently from the way it treats silence or ambiguity about the question 'whether a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement'—for in respect to this latter question the law reverses the presumption [favoring arbitration]."[37]

III. Enforcement Issues

A. Grounds to Refuse Enforcement

While the validity of the agreement is not subject to question, the real issue facing Orchid is the enforceability of an eventual award. In the United States, this should not present a significant obstacle, since all the parties to the contract are citizens of nations which are parties to the Inter-American Convention.[38] Article 5 of The Inter-American Convention provides extremely limited bases upon which recognition and enforcement of an arbitration decision may be refused:

> 1. The recognition and execution of the decision may be refused, at the request of the party against which it is made, only if such party is able to prove to the competent authority of the State in which recognition and execution are requested:
>
> (a) That the parties to the agreement were subject to some *incapacity* under the

applicable law or that *the agreement is not valid* under the law to which the parties have submitted it, or, if such law is not specified, under the law of the State in which the decision was made; or

(b) That the party against which the arbitral decision has been made was *not duly notified of the appointment of the arbitrator or of the arbitration procedure to be followed*, or was unable, for any other reason, to present his defense; or

(c) That the decision concerns a *dispute not envisaged in the agreement* between the parties to submit to arbitration; nevertheless, if the provisions of the decision that refer to issues submitted to arbitration can be separated from those not submitted to arbitration, the former may be recognized and executed; or

(d) That the *constitution of the arbitral tribunal* or the arbitration procedure *has not been carried out in accordance with the terms of the agreement* signed by the parties or, in the absence of such agreement, that the constitution of the arbitral tribunal or the arbitration procedure has not been carried out in accordance with the law of the State where the arbitration took place; or

(e) That the *decision is not yet binding* on the parties or has been annulled or suspended by a competent authority of the State in which, or according to the law of which, the decision has been made.

2. The recognition and execution of an arbitral decision may also be refused if the competent authority of the State in which the recognition and execution is requested finds:

(a) That the subject of the dispute *cannot be settled by arbitration under the law of that State*; or

(b) That the recognition or execution of the decision would be *contrary to the public policy* ("ordre public") of that State.

(Emphasis added).

These exceptions, which are nearly identical to those in the New York Convention, are interpreted extremely narrowly and should therefore not present a major barrier to enforcing an arbitration award.[39] As one court noted, "The Convention's public policy defense should be construed narrowly. Enforcement of foreign arbitral awards may be denied on this basis only where enforcement would violate the forum state's most basic notions of morality and justice."[40]

Also, in an action for enforcement of an arbitral award, the grounds for relief enumerated in Section 5 of the Inter-American Convention are the only grounds for setting aside an arbitral award.[41]

Since Jardins and probably Plantas have assets in New York, a New York venue would provide an easier road to enforcement. Once obtained, the award could be quickly confirmed pursuant to 9 U.S.C. § 207 and, pursuant to Fed. R. Civ. Proc. 64, in conjunction with the applicable rules of the New York CPLR, an injunction or attachment might be obtainable at the confirmation stage. Since Flores and Rosa seem to have no assets in the United States,[42] Orchid may have to bring suit abroad to enforce any arbitration award. Theoretically, the same or similar principles should apply in other Inter-American countries, but given the judicial delays in some Latin American countries and historical hostility to arbitration in others (*e.g.* Brazil), Orchid should consult local counsel before making any commitments. Orchid should also consider whether any potential losses might be insured or consider growers in jurisdictions where enforceability and delays will not be an issue.

B. Enforcement of Arbitral Award Against Plantas

Since the majority owner of Plantas is the Colombian government, the Foreign Sovereign Immunities Act (the "Act") is implicated. Plantas may seek to avoid (or at least delay) arbitration by invoking the Act. Pursuant to the Act, once Plantas presents a prima facie case that it is an agent or instrumentality of a foreign government, Orchid will have the burden of going forward with the evidence to show that immunity should not be granted under one of the exceptions to the Act.[43]

The provision of the Act conferring jurisdiction on the federal courts grants:

> original jurisdiction without regard to amount in controversy of any nonjury civil action against a foreign state as defined in § 1603(a) of this title as to any claim for relief in personam with respect to which the foreign state is not entitled to immunity either under §§ 1605–1607 of this title or under an applicable international agreement.

"Foreign state"[44] is defined as a political subdivision of a foreign state or an agency or instrumentality of

a foreign state.[45] "Agency or instrumentality" means an entity "(1) which is a separate legal person, corporate or otherwise, and (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and (3) which is neither a citizen of a State of the United States as defined in section 1332(c) and (d) of this title, nor created under the laws of any third country."[46] Plantas certainly falls within the purview of this definition, since it is a foreign corporation whose majority owner is the Colombian government.

Notwithstanding the general concept of sovereign immunity, Orchid will be able to enforce an arbitral agreement with the Colombian government or its agency or instrumentality under 28 U.S.C. § 1605. Subsection (a)(6) thereof provides for an exception to sovereign immunity in cases where a foreign state has agreed to arbitrate and "(A) the arbitration takes place or is intended to take place in the United States, (B) the agreement or award is or may be governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards." In our case, whether it be New York or California, arbitration is intended to take place in the United States. Secondly, as was previously discussed, our arbitration agreement is governed by the Inter-American Convention. Plantas will therefore not be immune from the jurisdiction of the American courts on the basis of the Act. At least one court has also used subsection B of § 1605(a)(6) to support compelling an instrumentality of a foreign government to submit to arbitration in London.[47]

Moreover it can be also argued under subsection (a)(1) that Colombia has implicitly waived its immunity by allowing itself to be party to this arbitration agreement. The House Report, which accompanied the Act, listed three examples of implicit waivers. Two of these examples were: (1) a foreign state has agreed to arbitrate in another country or (2) a foreign state has agreed that the law of a particular country shall govern.[48] When the contract names the United States as the forum for arbitration, "it is both reasonable and consistent with the legislative history to find an implicit waiver."[49] An arbitration agreement which names a forum for arbitration in the United States fits within the narrowest reading of the exceptions to the Act, and therefore, acts as a waiver of immunity for purposes of subject matter jurisdiction.

An additional basis for exercising jurisdiction over Plantas is under 28 U.S.C. § 1605(a)(2). This subsection provides for an additional exception to the Act when:

> the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

"Commercial activity" is defined as "a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose."[50]

If Plantas took part in "commercial activity" under § 1603(d) and it bears the relation to the United States required by § 1605(a)(2), then the foreign state is not entitled to immunity.[51]

IV. Other Arbitration Issues

A. Provisional Remedies

The law regarding provisional remedies in aid of an international arbitration taking place in New York, as well as in the remainder of the country, is unsettled. This is the type of issue that the parties might want to address explicitly in the arbitration clause to alleviate any uncertainty. The seminal case on provisional remedies in New York is *Cooper v. Ateliers de la Motobecane, S.A.*[52] In *Cooper*, the court stated that allowing the provisional remedy of attachment would defeat the purpose of the New York Convention, which was to inject a greater degree of certainty into international business dealings. "The [New York] Convention has considered the problems and created a solution, one that does not anticipate significant judicial intervention until after an arbitral award is made. The purpose and the policy of the UN Convention will be best carried out by restricting pre-arbitration judicial action to determining whether arbitration should be compelled."[53] *Cooper* has been followed in the New York state courts.[54] Meanwhile, in the New York federal courts, *Cooper* has been largely ignored. The Second Circuit has held that "entertaining an application for a preliminary injunction in aid of arbitration is consistent with the court's powers pursuant to § 206."[55] Due to the uncertainty surrounding this issue the parties would be best served by addressing this issue in the arbitration provision, thereby permissibly contracting around this uncertainty.

B. Institutional Rules

The proposed clause (probably copied from an old document) provides for arbitration pursuant to the "Commercial Arbitration Rules of the American Arbi-

tration Association." This may prove problematic. In September 2000, the American Arbitration Association repromulgated its International Rules and its Commercial Rules. The International Rules provide in Article 1 thereof that they apply to an international dispute unless the parties have otherwise designated "particular rules." Providing for the "Commercial Arbitration Rules" is probably a designation of "particular rules," and the parties may not have intended to forgo the longer deadlines and other provisions of the International Rules. Of course, at the time of arbitration the parties may agree on which rules to apply or one party might seek to enforce its view by seeking relief from the courts. The latter route is likely to do no more than delay the proceedings, because the courts have consistently held that procedural issues are for the arbitrators to decide.[56]

It is recommended that if the Commercial Rules are in fact desired, the clause be amended to provide that the arbitration be pursuant to the "Commercial (and not International) Rules."

The parties should also review whether they in fact want institutional supervision (and its attendant costs) or whether they may simply want to proceed under the UNCITRAL Rules which allow for *ad hoc* arbitration. Also, these parties should be aware that, if they specify no rules, Article 3 of the Inter-American Convention provides that the rules of procedure of the Inter-American Commercial Arbitration Commission will apply.

Finally, the parties' counsel should review and be familiar with whatever rules are chosen in order to avoid any surprises down the line.

C. Selection of Arbitrators

The parties' proposed clause defers to the AAA's Commercial Rules for the selection of arbitrators. To a large extent this removes control from the parties' hands, since the choices are limited to the AAA's panel of arbitrators, which may or may not include the desired expertise.[57] The clause also leaves to the AAA whether there will be one or three arbitrators. The parties might wish to provide for each to select an arbitrator and a third to be selected by the AAA. Or, to minimize costs, the parties may state that this dispute will be heard by one arbitrator pursuant to the relevant AAA rules.

It should be made clear to Orchid that, even if it appoints its "own" arbitrator, that arbitrator will act as a neutral and must be impartial.[58]

D. Language

The proposed clause makes no provision for the language of the arbitration. Given the varying nationalities of the parties, specification of the language of arbitration is warranted. Similarly, the parties may wish to specify whether translations into such language of any evidentiary documents will be necessary.

V. Alternatives to Arbitration

A. Litigation in New York

Normally, litigation is a more expensive alternative to holding arbitration in New York or California under New York law, because arbitration hearings are usually less burdensome. Discovery may be minimal or eliminated altogether and the parties will usually spend less time haggling over evidentiary issues. Arbitration, therefore, usually takes a shorter period of time, which is a source of further savings, both in terms of legal costs and the uncertainty associated with unsettled litigation.

The New York courts do, however, present certain advantages in contractual disputes that merit consideration. The New York state court system has a Commercial Part that is designed to handle commercial disputes in a businesslike manner, focusing on providing expert and cost-effective adjudication of these cases.[59] Moreover, where a claim is for a sum certain (*e.g.*, enforcement of a promissory note), New York also provides a summary procedure in CPLR § 3213 that allows the plaintiff to move summarily for judgment, by-passing the pleading stage. Nevertheless, the deciding factor here is that enforcing a United States court judgment abroad is still more difficult and costly than enforcing an arbitration award, because the United States is not a party to any convention on the enforcement of judgments.[60] Accordingly, enforcement of an arbitral award rendered in the U.S. should be easier than enforcing a U.S. judgment, and that probably militates in favor of arbitration in the instant case.

B. Litigation in the Growers' Countries

Another possible alternative is litigation in the growers' jurisdictions. However, it is not recommended that Orchid submit to the growers' jurisdictions because of the inconvenience and excessive cost of litigating in a foreign country.[61] The diversity of legal systems involved, the requirement of engaging local counsel and the probable need for extensive translations could increase the cost of this transaction so significantly as to offset any financial gains Orchid expects to reap. Also, the cost to Orchid of educating itself with regard to the laws of these nations, so as to mitigate future uncertainty, would be prohibitively expensive. This problem would be compounded by the fact that Orchid could theoretically face litigation in four different countries with different procedures, since it is contemplating contracting with growers in this number of countries. Also, Orchid would be the foreign party in these suits, so it is also likely to face some bias from courts trying to pro-

tect the interests of domestic companies. Furthermore, even if Orchid were able to get a judgment in one of these jurisdictions, it might still face considerable difficulty in enforcing any judgment locally because of delays.

VI. Conclusion

Having weighed the advantages of litigation versus arbitration and concluded arbitration is likely to be the better alternative for Orchid, it is nevertheless recommended that Orchid consult local counsel in the growers' jurisdictions before committing to such a course of action. Given the time constraints seemingly imposed by the last-minute negotiations, Orchid may wish to provide that at its choosing, Orchid may resolve a dispute by arbitration *or* litigation and provide the relevant procedures for instituting both alternatives.

Endnotes

1. *See Cooper v. Ateliers de la Motobecane, S.A.*, 57 N.Y.2d 408, 411 (1982). *See also* Taherzadeh, *Comment: International Arbitration and Enforcement in U.S. Federal Courts*, 22 Hous. J. Int'l L. 371 (2000).
2. *See Cooper*, note 1 *supra*, at 411.
3. *See Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 270 (1994).
4. *Id.*
5. *See* 9 U.S.C. § 1 *et seq*. Wholly intrastate arbitrations are governed by the laws of the individual states. Most states (but neither New York nor California) have adopted the Uniform Arbitration Act. Several states (including California), hoping to attract international business disputes to the state court systems, have adopted the Model UNCITRAL Act. *See* J. Barist, *Comm'l Arbitration Law & Clauses* (1994) and appendices thereto.
6. *See* 9 U.S.C. § 201 note.
7. *See* 9 U.S.C. § 301 note.
8. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985), *citing Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24–25 (1983).
9. *See* 9 U.S.C. § 9. S*ee also Cortez Byrd Chips, Inc. v. Bill Harbert Construction Co.*, 529 U.S. 193, 203–204 (2000). It should be noted that for domestic arbitration, "[t]he Federal Arbitration Act does not create an independent basis for federal jurisdiction. Apart from the requirements of the Act, diversity of citizenship or a federal question is requisite for federal jurisdiction." *Hamilton Life Ins. Co. of New York v. Republic Nat'l Life Ins. Co.*, 291 F. Supp. 225, n.3 (S.D.N.Y. 1968), *aff'd*, 408 F.2d 606 (2d Cir. 1969). Due to the fact that Chapter 1 of the FAA does not create an independent basis of federal jurisdiction, non-diverse parties will have questions relating to their arbitration agreements adjudicated in state courts. As will be discussed, *infra*, both Chapters 2 and 3 provide an independent basis for federal jurisdiction.
10. 9 U.S.C. § 10.
11. 9 U.S.C. § 3.
12. *See* 9 U.S.C. § 202. The New York Convention does not define what a domestic or nondomestic award is. Accordingly, each party to the Convention must do so.
13. *David L. Threlkeld & Co., Inc. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 248 (2d Cir. 1991).
14. Inter-American Convention on International Commercial Arbitration, 30 January 1975, art. 1.
15. *See* 9 U.S.C. §§ 302–306.
16. 9 U.S.C. § 305.
17. 9 U.S.C. § 302.
18. *See* 9 U.S.C. §§ 203 and 302.
19. *Ministry of Defense of Islamic Republic of Iran v. Gould Inc.*, 887 F.2d 1357, 1362 (9th Cir. 1989). *See U.S. Titan, Inc. v. Guangzhou Zhen Hua Shipping Co., Ltd.*, 241 F.3d 135 (2d Cir. 2001); *Productos Mercantiles E Industriales, S.A. v. Faberge USA, Inc.*, 23 F.3d 41 (2d Cir. 1994). *See also* 9 U.S.C. § 202.
20. 9 U.S.C. § 1.
21. *Bergesen v. Joseph Muller Corp.*, 710 F.2d 928, 932 (2d Cir. 1983).
22. *Productos Mercantiles*, note 19 *supra,* 23 F.3d at 45.
23. *See Smith/Enron Cogeneration Ltd. Partnership, Inc. v. Smith Cogeneration Int'l, Inc.*, 198 F.3d 88 (2d Cir. 1999) (so stating with respect to New York Convention).
24. *Productos Mercantiles*, note 19 *supra,* 23 F.3d at 45, *quoting* H.R. Rep. No. 501, 101st Cong., 2d Sess. 4 (1990), reprinted in 1990 U.S.C.C.A.N. 675, 678.
25. *Id*.
26. *See David L. Threlkeld & Co, Inc.*, note 13 *supra*, 923 F.2d at 248. *See also Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 844 (2d Cir. 1987).
27. *Insurance Co. of North America v. ABB Power Generation, Inc.*, 925 F. Supp. 1053, 1058 (S.D.N.Y. 1996).
28. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Lecopulos*, 553 F.2d 842, 844 (2d Cir. 1977).
29. *Id., citing Victory Transport Inc. v. Comisaria General de Abastecimientos y Transportes*, 336 F.2d 354, 363 (2d Cir. 1964). New York law also provides in General Obligations Law § 5-1402 that, notwithstanding a lack of contacts with New York,

    > any person may maintain an action or proceeding against a foreign corporation, non-resident, or foreign state where the action or proceeding arises out of or relates to any contract, agreement or undertaking for which a choice of New York law has been made in whole or in part pursuant to section 5-1401 and which (a) is a contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate, not less than one million dollars, and (b) which contains a provision or provisions whereby such foreign corporation or non-resident agrees to submit to the jurisdiction of the courts of this state.

30. *See, e.g.*, CPLR § 7502 (McKinney's 1998) Practice Commentaries, § 7502:1.
31. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 470 (1989).
32. *See also* N.Y. Gen. Oblig. Law § 5-1401.
33. *See Smith/Enron*, note 23 *supra*, where defendant argued that, notwithstanding a specific clause stating arbitration was to be governed by the FAA, choice of New York venue implied that New York arbitration law would govern proceedings.
34. *Volt Information Sciences*, note 31 *supra*, at 478, *quoting Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).
35. *See Smith/Enron*, note 23 *supra. See also Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995) (holding that arbitrators could order punitive damages notwithstanding New York

choice of law clause because the parties agreed that the NASD Rules would govern their arbitration and such Rules allowed arbitrators to order punitive damages); and *Smith Barney, Harris Upham & Co. v. Luckie*, 85 N.Y.2d 193 (1995) (New York choice of law clause allowed the court and not the arbitrator to consider statute of limitations as per CPLR § 7502).

36. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995).

37. *Id*. at 994–995.

38. *See Employers Ins. of Wausau v. Banco De Seguros Del Estado*, 199 F.3d 937 (7th Cir. 1999) (discussing enforcement pursuant to the Convention where the parties were from U.S. and Uruguay).

39. *See Donel Corporation v. Kosher Overseers Ass'n of America*, 2001 U.S. Dist. LEXIS 2314, 7 (S.D.N.Y. 2001): "The party seeking to avoid confirmation of the award bears the burden of proof. So long as there exists 'a barely colorable justification' for the arbitration award, it should be enforced." *See also Meadows Indem. Co. Ltd. v. Baccala & Shoop Ins. Services, Inc.*, 760 F. Supp. 1036, 1042 (E.D.N.Y. 1991): "The purpose of the Convention, to encourage the enforcement of commercial arbitration agreements, and the federal policy in favor of arbitral dispute resolution require that the subject matter exception of Article II(1) [of the New York Convention] is extremely narrow."

40. *Parsons & Whittemore Overseas Co, Inc. v. Societe Generale De L'Industrie Du Papier, (RAKTA),* 508 F.2d 969, 974 (2d Cir. 1974).

41. *But see Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc.*, 126 F.3d 15, 20 (2d Cir. 1997) (holding judge-made "manifest disregard of the law" exception not applicable in New York Convention cases where arbitration held abroad but it can be a basis for vacatur in U.S.-based arbitrations).

42. Orchid might want to inquire of its California lawyers whether it could enforce against Rosa's receivables from the San Diego florists.

43. *See Cargill Int'l S.A. v. M/T Pavel Dybenko*, 991 F.2d 1012, 1016 (2d Cir. 1993).

44. 28 U.S.C. § 1330(a).

45. 28 U.S.C. § 1603(a).

46. 28 U.S.C. § 1603(b).

47. *See U.S. Titan v. Guangzhou*, note 19 *supra*.

48. *See Cargill Int'l*, note 43 *supra,* at 1017 (citing House Report at 18, reprinted in U.S.C.C.A.N. at 6617).

49. *Maritime Ventures Int'l., Inc. v. Caribbean Trading & Fidelity, Ltd.*, 689 F. Supp. 1340, 1351 (S.D.N.Y. 1988).

50. 28 U.S.C. § 1603(d)(2).

51. *See Texas Trading & Milling Corp. v. Federal Republic of Nigeria*, 647 F.2d 300, 308 (2d Cir. 1981).

52. 57 N.Y.2d 408 (1982). *See also McCreary Tire & Rubber Co. v. Ceat S.p.A.*, 501 F.2d 1032 (3d Cir. 1974).

53. *Cooper v. Ateliers de la Motobecane, S.A.*, 57 N.Y.2d 408, 417 (1982).

54. *See Drexel Burnham Lambert Inc. v. Ruebsamen*, 139 A.D.2d 323, 330 (N.Y. App. Div. 1988).

55. *Borden, Inc. v. Meiji Milk Products Co., Ltd.*, 919 F.2d 822, 826 (2d Cir. 1990). For a relatively recent summary of the law, see Newman, *International Arbitration – Unfinished Business*, N.Y.L.J. (3 April 2001) at 3.

56. *See Bancol y Cia. S. En C. v. Bancolombia S.A.*, 123 F.Supp.2d 771 (S.D.N.Y. 2000) (declining to determine whether rules of Inter-American Commercial Arbitration Commission would apply).

57. In a recent matter involving the need for trusts and estates experience, the selected arbitrator had significant antitrust experience.

58. AAA International Arbitration Rule No. 7. *See also* Code of Ethics for Arbitrators in Commercial Disputes.

59. *See* Goldstein and Ruskin, *A Visit to a New York Court Need Not be an Ordeal*, Nat'l L.J., 28 June 1999, at C9.

60. *See, e.g.*, the Brussels and Lugano Conventions of the European Union discussed in von Mehren, *Recognition and Enforcement of Foreign Judgments: A New Approach for the Hague Conference*, 57 Law & Contemp. Probs. 271, 276 (Summer 1994). In 1992, the U.S. proposed that the Hague Conference on Private International Law draft a new, multilateral convention dealing with the recognition and enforcement of foreign judgments. A special Commission to the Hague Conference was convened in 1994 to begin preliminary work on such a convention and the draft Hague Convention on International Jurisdiction and the Effects of Judgments in Civil and Commercial Matters was provisionally adopted in June 1999 and revised in October 1999. The 30 October 1999 version was in turn revised at the Diplomatic Conference held 6-22 June 2001. The latest draft may be found at http://www.hcch.net. Federal implementing legislation is also in the works. *See* 30 November 1998 letter from Profs. Lowenfeld and Silberman to the ALI at http://www.ali.org/ali/1999_Lowen1.htm.

61. *See David L. Threlkeld & Co., Inc.*, note 13 *supra,* 923 F.2d at 248: "Enforcement of international arbitral agreements promotes the smooth flow of international transactions by removing the threats and uncertainty of time-consuming and expensive litigation."

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Arbitration Versus Litigation in Colombia

By Jorge Posada-Villaveces

I. Discussion

A. Is International Arbitration Available?

Under Colombian law, the applicable law for a contract to be executed in that country should be Colombian law, *unless* international arbitration is specified. In that case the parties are at liberty to elect the law that will govern the contract.

International arbitration, however, is not available for all contractual relationships. Only if one of the following conditions has been met may international arbitration be validly specified:

- The parties, at the time they agree to the dispute resolution clause, have their domiciles in different countries.
- A substantial part of the performance of contractual obligations directly related to the trial would take place outside the country where the parties have their domicile.
- The venue for arbitration is not in the same country as where the parties are domiciled, as long as this was agreed to in the dispute resolution clause.
- The matter clearly addresses the interests of more than one state and the parties have expressly agreed to international arbitration.
- The matter subject to arbitration clearly affects interests related to international commerce.

The contract to be entered into between Orchid and Plantas clearly meets more than one of the aforementioned conditions. Thus, international arbitration may be validly agreed to in this contract. The arbitration clause would, however, have to be amended in order for the choice of law to be valid. Specifically, the arbitration clause should specifically refer to international arbitration:

> Any and all disputes arising out of or relating to this Agreement shall be finally settled by *international* arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitration shall take place in San Francisco, California.

B. Alternatives?

The question remains, however, if the dispute resolution agreed upon will best serve Orchid's interests, or if a better alternative exists.

The relevant issues include the fact that Plantas is a Colombian company. Any award granted by an arbitration board would eventually have to be enforced in Colombia. This may present certain problems, since an award granted by an international arbitration board would, for all effects, be considered to be a foreign ruling and, therefore, subject to *exequatur* proceedings in Colombia before being enforceable in Colombia.

Even though the *exequatur* proceeding is quite straightforward, obtaining a court acceptance of the arbitral award would nevertheless take anywhere from one to three years, depending on the court workload and the resistance offered by Plantas during the *exequatur* proceedings. The need for an *exequatur* would also arise if the matter is submitted to the New York courts.

The alternative of submitting the matter to either Colombian courts or Colombian arbitration would present its own particular problems. In the Colombian courts, congestion could be an issue and the amount of time required to obtain a final judgment could easily exceed eight to ten years. A purely Colombian arbitration, submitting to Colombian legislation, may leave Orchid guessing as to its rights under Colombian law while, at the same time, New York law may offer Orchid better, more comprehensive, protection.

The best solution may thus be to combine a Colombian ruling or arbitral award—in order to avoid the process of *exequatur*—with the law of New York. Thus international arbitration with its seat in Colombia could well be the solution.

II. Proposed Contract Language

A new arbitration clause is thus proposed, as set forth below.

The proposed clause addresses the main concerns that Orchid may have, such as applying the laws of the State of New York, obtaining a prompt judgment, and ensuring that the procedure for enforcement of the award is not, in itself, a drawn-out ordeal for Orchid.

A. Governing Law and Jurisdiction

This contract shall be deemed to have been negotiated and made in, and shall be governed and interpreted under, the laws of the State of New York, United States of America, applicable to agreements made by residents thereof to be wholly performed therein.

B. Dispute Resolution Procedures

(1) Any dispute, controversy or claim arising out of or relating to this Contract or breach hereof, shall be settled in accordance with the Rules and Procedures of the Centro de Arbitraje y Conciliación de la Cámara de Comercio de Bogotá (hereinafter the "CAC"), as currently in force, by three arbitrators. The CAC shall administer the arbitration under its rules. In the event there is a procedural rule or other matter not covered herein or in the CAC rules, Colombian procedural law shall govern.

(2) Both Parties shall appoint two (2) arbitrators within a period of 15 days from the date so requested by CAC. One arbitrator must be a citizen of the United States of America and the other from Colombia. The CAC will appoint the third arbitrator from a different nationality and not from the CAC's list of arbitrators. The arbitrators shall be attorneys with experience in _____, and at least the United States national must have a complete knowledge of the laws of the State of New York. If the Parties fail to appoint the two (2) arbitrators within the period provided for above, the CAC will appoint said arbitrators.

(3) The arbitration, including the rendering of the award, shall take place in Bogotá or Cartagena, Colombia, as agreed by the arbitrators and the proceedings shall be conducted in Spanish. In such proceedings this Contract shall be construed, and the obligation of the parties shall be determined, in accordance with the laws of New York (without giving effect to the conflict of laws provisions of such state).

(4) The award of the arbitrators shall be final and binding and shall be delivered within the six (6)-month period stipulated by Colombian law. The arbitrators may issue interim awards and order any provisional measures which should be taken to preserve the respective right of any Party and may require the defeated party to pay the costs of the procedure.

(5) Any award rendered by the arbitrators shall be payable in United States dollars. Judgment upon the award rendered may be in any court having jurisdiction, or application may be made to any such court for a judicial acceptance of the award and an order of enforcement, as the case may be. Each of the Parties agrees not to assert, by way of motion, as a defense or otherwise, in any arbitration instituted hereunder, or in any enforcement action, suit or proceeding, instituted pursuant to such arbitration, any claim that it is not subject personally to the jurisdiction of the arbitral panel or court, as the case may be, that the arbitration, action, suit or proceeding is brought in an inconvenient forum, that the venue of the arbitration, action, suit or proceeding is improper or that this Contract or the subject matter hereof may not be enforced in or by such arbitral panel or court. Any and all service of process and any other notice in any such arbitration shall be effective against any Party if given personally or by registered or certified mail, return receipt requested, or by any other means of mail that requires a signed receipt, postage prepaid, mailed to such Party as herein provided, or by personal service on an agent designated in writing by such Party with a copy of such process mailed to such Party by registered mail, return receipt requested, postage prepaid. Nothing herein contained shall be deemed to affect the right of any Party to serve process in any manner permitted by law.

(6) The Parties waive any right they may enjoy under the law of any nation to apply to the courts of any such nation for relief from the provisions of this clause or from any decision of the arbitrators made prior to the award.

(7) This arbitration clause is agreed by the parties as their desire is to solve all their disputes by an international arbitration panel as permitted by Law 315 of 1996 of Colombia, with the understanding that such arbitration process and award is Colombian and consequently when finally fully enforceable in Colombia without any exequatur process.

(8) This Arbitration Agreement will remain effective even after the termination of the Contract.

C. Waiver of Immunity:

The Parties hereby waive any right they may have to claim sovereign or diplomatic immunity.

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The Orchid Problem: Litigation Versus Arbitration in Argentina

By Emilio N. Vogelius

I. Introduction

Although arbitration has become in Argentina a more frequent way to resolve disputes arising between different parties, and even though the local court system (especially the commercial courts) is increasingly overloaded, each time that a comparison of arbitration and judicial litigation is brought up for analysis and discussion, we continue to wonder why arbitration is not an alternative chosen over litigation even more frequently than it is now.

After all, arbitration provides various advantages, such as the following.

- Arbitration allows the parties the possibility to select arbitrators to resolve the conflict, rather than having to submit the dispute to a court judge who is not always a judge that the parties would have chosen for such purpose.
- Arbitration allows the parties the ability to select procedural standards that allow more effective and efficient proceedings.
- The duration of the arbitration process should be shorter than the judicial process.
- Arbitration allows the parties the possibility to appraise more accurately the likely costs of the dispute resolution.

When thinking of the reasons that will lead the parties to choose judicial litigation over arbitration, we imagine that such reasons might be focused on a distrust in the viability of having the arbitration award judgment enforced or the reluctance of a party that is aware of its weak position to resort to an arbitration tribunal, since such a party may want to take advantage of the slowness of legal proceedings.

However, the truth is that the alternative of arbitration cannot be disregarded, especially if we take into account the quality and prestige of both national institutions (such as the Buenos Aires Stock Exchange and the Chamber of Commerce) and international institutions (such as the International Chamber of Commerce) that offer the alternative of an arbitration tribunal for the solution of conflicts.

Below we shall deal with various matters that, we believe, are usually considered when choosing between litigation in courts and arbitration.

II. Extension of Jurisdiction

Reviewing the Orchid Problem we believe that, according to Argentine law and regulations, it is possible to grant jurisdiction to foreign arbitrators to resolve the disputes in question. We will, therefore, summarize the procedural rules in force in Argentina.

Argentine law views the creation of an arbitral panel as a transfer or extension of what would customarily be judicial jurisdiction to the arbitrators—thereby displacing the judiciary. Article 1 of the National Code of Civil and Commercial Procedures provides that it is permissible to convey the court's jurisdiction to foreign judges or arbitrators in order to decide an international conflict.

This rule is included in the National Code of Civil and Commercial Procedures by Law No. 22434, which effectively continued the rule established in Law No. 17454 of September 1967. The 1967 legislation allowed the possibility of having the jurisdiction of judges extended in matters concerning assets, "but not in favor of foreign judges or arbitrators acting outside Argentina."

As expected, the 1967 Law was strongly criticized, with the result that Law No. 21305 of April 1976 amended it. Accordingly, the extension of jurisdiction in favor of foreign arbitrators and courts was authorized, provided that the issues were not specifically designated by Argentine law as those for which Argentine judges had exclusive jurisdiction and provided that the agreement whereby the extension of jurisdiction was agreed to dated from before the occurrence of the facts that were the basis for the intervention of the foreign judges or arbitrators.

Law No. 21305 of 1976 was repealed and replaced by Article 1 of Law No. 22434 of 1981, which allows the extension of jurisdiction in cases of international conflicts whenever the Argentine courts do not have exclusive jurisdiction on the issue and when the conflict relates to assets.

III. The Arbitration Clause

The Orchid Problem includes a standard clause, which under Argentine law is valid and enforceable. However, given the past hostility of Argentine law and Argentine courts toward arbitration and in order to avoid any misunderstandings, it is usual (although not mandatory) when drafting arbitration clauses to include

a statement specifically waiving the parties' right to appear in the courts.

IV. Choosing between Arbitration and Litigation

We have already stated that it is possible to grant jurisdiction to foreign arbitrators in regard to disputes such as the ones that could arise from the Orchid Problem. We have also stated that the arbitration clause is a valid and enforceable clause. From a strict legal standpoint, there are no reasons to challenge the clause. Let us, then, give some thought to the alternatives we face each time we have the opportunity to choose between arbitration and judicial litigation: Why would we prefer arbitration instead of judicial litigation or vice versa?

In this Part IV we have included different factors that, in our experience, should be considered when selecting between arbitration and litigation or even when choosing different arbitration institutions. However we ought to highlight that the personal experience of each lawyer cannot be replaced and will often be decisive: Each matter is different and the position of each person, company or entity is also different at the time of the execution of the relevant agreement or contract.

A. Is Time Important?

Is the client interested in litigating for several years or is the client interested in resolving the dispute as soon as possible? Often that is a matter of considering, in light of the specific contractual arrangement, what kind of disputes are likely to arise and who is likely to be the plaintiff and who is likely to be the defendant in connection with those disputes. That question should be considered by every lawyer that has to choose between litigation and arbitration. And once a dispute has arisen, it may be necessary to have a certain "feeling" about when it is convenient or necessary for the client to approach the other party searching for a settlement—and when it is better not to make such an approach.

At least in Argentina, a judicial procedure, from its very beginning up to the notice of the final judgment, with some adjustment for degree of complication, never lasts fewer than two years.

If a quick decision is important, our experience tells us that arbitration procedures are much quicker than judicial actions, without considering the time that is needed to enforce an award.

B. Where Does the Client Feel More Comfortable?

We think that it is important that a client who is involved in a dispute feels as comfortable as possible both before and during the procedure. The client should feel that its statements are being listened to and understood. The client, therefore, needs to feel comfortable with the language used and with the way in which procedures are carried out. The client needs to feel comfortable with the environment that surrounds the tribunal. We could imagine that a small company, such as Flores in the Orchid Problem, would feel much more uncomfortable in New York than Plantas, which appears to be a cosmopolitan entity.

The question that heads this section can apply to different matters that could make a party to a dispute more or less comfortable in a specific case. The language to be used in the dispute resolution procedures is surely one of those matters.

C. Cost

Cost is also an important matter to consider. We are sure that high costs will make any client uncomfortable. In this respect, at least in Argentina, it is much easier to estimate the costs of an arbitration procedure than the costs of a judicial one. Nevertheless, the number of arbitrators, the fee and expense system of the designated arbitration association, and the extent of evidentiary discovery allowed by agreement of the parties or the relevant arbitration rules have a significant bearing on the costs of arbitration.

D. Location

In some places localism is an issue that has to be considered, not only when choosing a place of arbitration, but also when considering the place where the award will be eventually enforced. In our experience, courts from some cities or countries tend to be more than pleased to search for any excuse that will help their fellow citizens deal with the problem locally rather than having to contend with a foreign forum. This is a bias that affects not only arbitration. It happens to every lawyer that has to litigate outside his or her hometown. We think that appointing well-known arbitration associations to handle the procedures can minimize the effects of this problem.

Nevertheless, one should consider not only the cost of obtaining the initial judicial decree or arbitral award, but also the cost of enforcement—which may include the cost of overcoming judicial hostility in the jurisdiction of enforcement or collection to a foreign decree or award.

E. Bond

The Argentine Procedural Code includes a formal defense that allows the defendant to stop the progress of a lawsuit if a plaintiff who is not domiciled in Argentina and has no assets in the country does not guarantee payment of the eventual liabilities of plaintiff that may arise from the lawsuit. This defense is named

"*excepcion de arraigo*," and was called "*cautio judicatum solvi*" in the past.

Argentina has executed several treaties with different countries (almost all European countries) establishing that foreigners will be treated in the same way as locals, which means that in the case of plaintiffs from those treaty countries this formal defense does not apply. But to our knowledge there is no treaty signed with the U.S. including such a rule. Thus international arbitration is a way for an American plaintiff to avoid this defense.

F. Preliminary Relief

In the event that preventive or preliminary relief is necessary or convenient in order to assure the status quo during the dispute resolution procedure, such relief is much more effective if a court issues it. If an arbitration tribunal issues such a preliminary relief, it is always necessary to enforce such measure through the courts. All these procedures are time consuming, and time is of the essence when seeking preliminary relief. To this extent, preliminary judicial relief appears to be much more effective.

G. Subject Matter

The subject matter of the dispute that is eventually to be resolved should be considered at the time of choosing between arbitration or litigation, or even when selecting the arbitration association to appoint. The key question is the following: in the event of a conflict, would we be facing a dispute over facts or a technical matter or a matter of law?

In our opinion, arbitration is much more effective when litigating about matters of law or matters that involve technical aspects, mainly because of the ability to arrange between the parties for the selection of arbitrators or technical experts knowledgeable in the subject matter of the dispute.

V. Enforcement of Foreign Awards

In the past, the Argentine law of civil procedure relating to foreign law did not deal specifically with the local enforcement of foreign arbitration awards as something separate and distinct from the enforcement of judgments rendered by foreign courts. As a consequence, the same rules were applied to the local acknowledgment of both foreign arbitration awards and foreign court judgments.

In Werner Goldschmidt's opinion, an arbitration award is considered foreign if it has been issued by a foreign arbitration tribunal, if the arbitration has been carried out in a foreign country and, besides that, if Argentine law has not been applied either because foreign law was applicable or because the arbitration tribunal has judged "*ex aequo et bono*."[1] The New York Convention establishes that arbitration awards shall be deemed foreign when issued outside the territory of a country.

In this context, consider the requirements to be met under Articles 517 through 519 of the Argentine National Code of Civil and Commercial Procedures to allow foreign arbitration awards to be enforced. It should be noted that, except for two specific requirements, the conditions for enforcement are similar to those relating to foreign judgments and foreign awards.

According to Article 517 of our National Code of Civil and Commercial Procedures, if there is no treaty, in order to enforce an arbitration award, the following requirements must be met:

- The award must be final and must be issued by a competent court or arbitration panel.
- The party against whom the award is being enforced must have been personally summoned and been allowed the opportunity to defend its legal rights.
- The award must be considered final and valid in accordance with the law of the place in which it is issued.
- The arbitration award cannot violate legal principles which offend the Argentine notion of public order.
- The award must not be inconsistent with former or simultaneous Argentine judgments.[2]

Endnotes

1. *Derecho Internacional Privado*, 488 (1982).
2. Article 519 bis also includes two additional requirements, exclusively applicable to the enforcement of arbitration awards, which must be met to allow such enforcement: (i) the extension of jurisdiction is subject to the provisions of Article 1 of the National Code of Civil and Commercial Procedures referred to at the beginning of this article; and (ii) the subject matter submitted to arbitration must be capable of being settled.

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Litigation Versus Arbitration in the Americas: Advantages and Disadvantages: A Brazilian Perspective

By Selma M. Ferreira Lemes

I. Introduction

It is important to limit the discussion of arbitration versus litigation to the matters that Brazilian law permits private parties to regulate freely by contract. Accordingly, matters related to criminal law, tax law, family law, and the like are excluded from this discussion, since Brazilian law does not allow those topics to be regulated by agreement of the parties. On the other hand, all other disputes arising from rights and obligations freely agreed to within the scope of the general obligations law may be submitted to arbitration.

II. Discussion

A. Background

From the Brazilian point of view, the analysis of litigation versus arbitration would have been entirely different if proposed before the new law on arbitration, Law No. 9307, of 23 September 1996 was enacted. Before that law became effective, the analysis would have recommended litigation before arbitration, since the Code of Civil Procedure previously discouraged the use of arbitration.

There were two reasons for this.

First, the law did not grant binding mandatory effect to the arbitration clause. Thus, if the clause was not complied with, the effect was the same as if there had been a default of any other contractual clause: It was considered to be a simple promise to contract, for which the remedy would be a damage claim. Arbitration would only be constituted and obligatory if the parties later executed an arbitration agreement.

Second, the issued arbitration award, in order to be effective and valid, required judicial ratification.

In view of these circumstances, arbitration was very seldom used domestically. In international arbitration the situation was a little better, since the Protocol of Geneva of 1923 was in force in Brazil, and called for the recognition of arbitration clauses. Thus Decree No. 21187/32 set forth that in international agreements the arbitration clause had binding effect. This understanding was ratified by case law by the higher courts.[1]

With the arbitration law of 1996, the situation was changed and arbitration started to become a more effective instrument to resolve disputes. The 1996 law of arbitration originated from the Model Law on International Commercial Arbitration of the United Nations Commission for International Business Law Development (UNCITRAL) of 1985 and broadly recognizes the autonomy of the contracting parties to structure their contractual arrangements, including dispute resolution, as they wish.

Below we will outline the main characteristics of the Brazilian arbitration statute, and also discuss some aspects of the law and the judicial interpretations of it, which in this relatively short period of time (five years) have helped dissipate misunderstandings as to the correct interpretation of the law and to demonstrate that the Brazilian judiciary, both in the lower courts and in the highest court, the Supreme Federal Court (often abbreviated as "STF"), specifically by ruling on the constitutionality of some provisions of the law, have accepted the concept of arbitration.

B. Chief Features of the Arbitration Law

1. The Agreement to Arbitrate

Parties to a contract are free to stipulate arbitration as the means to resolve their disputes. They may do this by entering into an arbitration agreement ("*convenção de arbitragem*"), which entails agreement to an arbitration clause ("*cláusula compromissória*"), or after a dispute arises, the parties may agree to solve it by arbitration ("*compromisso arbitral*").[2]

The arbitration clause ("*cláusula compromissória*") is the convention through which the parties to an agreement undertake to submit to arbitration the disputes that may arise under that agreement. The arbitration clause must be set forth in writing and may be articulated in the underlying agreement itself or in a separate document that references the underlying agreement.[3]

The "compromise" ("*compromisso arbitral*") is the convention through which the parties submit a dispute to arbitration by one or more arbitrators, which may be done either in a court or extrajudicially.[4] The "compromise" document sets forth the following:

- A description of the dispute to be resolved.
- The names and qualifications of the arbitrators and their alternates.
- The procedural rules to be followed.

- Authorization for the arbitrators to come to a decision on equitable grounds, that is, outside the ordinary legal framework, applying the criteria of fairness and actual knowledge and understanding.[5]

2. Applicability of Custom and Usage; International Rules of Commerce

Brazilian law permits custom and usage, as well as international rules of commerce, to be applied in an arbitration proceeding, and the parties may agree that the arbitration be conducted using such principles and rules.[6] The fact that rules established by the international community may be taken into account means that important aspects of international commercial custom and usage such as Incoterms and the Uniform Customs and Practice for Documentary Credits, as well as *Lex Mercatoria,* will find their application in the arbitration context.

The parties may freely choose the substantive law to be applied in the arbitration, provided that this does not violate good practice and the public order.[7] If not stipulated by the parties, the procedural rules are determined by the arbitrators unless it is an arbitration administered by an arbitration institute that has its own regulations. In deciding whether to apply foreign substantive law in deciding the dispute, the arbitrators will follow the practice and case law established in the foreign country selected by the parties.

3. Compelling the Arbitration

If parties have agreed to a mandatory arbitration clause that requires the parties to resolve all controversies through arbitration, a special procedure may be instituted to compel compliance with that arbitration provision. A valid arbitration agreement in effect removes the jurisdiction of the courts, such that, if a party to the arbitration agreement resists the commencement of the arbitration, the other party to that agreement may commence an action to compel arbitration in particular circumstances.[8]

4. Binding Nature of the Arbitration Award

The arbitration award is accorded the same effect as the final judgment of a court and is not subject to certification or appeal.[9]

5. "Competence/Competence" Principle

Brazilian law follows the "competence/competence" principle, that is, the arbitrator is competent to decide whether he or she is competent to decide the matter. Put another way, the arbitrator may rule whether he or she has jurisdiction in the particular matter at hand.[10] In this regard, Brazilian law tracks modern arbitration legislation, including Spanish law, French law, and the Model Law on International Commercial Arbitration adopted by UNCITRAL.

6. Severability of the Arbitration Clause

Brazilian law provides that the arbitration clause stands alone. Thus, if the validity of the larger agreement of which the arbitration clause forms a part is at issue, the question of such validity is to be settled by arbitration. This is so because of the independent validity of the arbitration clause, and an allegation of nullity or unenforceability asserted in respect of the overall agreement does not affect that independent validity.[11]

7. Settlement

If, during the pendency of the arbitration, the parties reach an amicable settlement of their differences, the arbitrators may issue an arbitration award embodying that settlement.[12]

8. Ethical Requirements; Arbitrator Qualifications

Brazilian law sets forth an ethics code to which the arbitrator must adhere by performing his or her functions with impartiality, independence, competence, diligence and discretion.[13] Any capable person may be chosen by the parties to serve as arbitrator,[14] and there is no restriction as to the nationality of the arbitrator.

9. Modification of the Award

An arbitration award may be corrected, upon request of the parties, in the event it contains a material error, obscurity, doubt or contradiction.[15]

10. Judicial Review

Recourse against an arbitral award by application to a court to set aside the arbitral award is possible in certain cases in the event of certain defects.[16] There can be an action to enforce the arbitration award as well.[17] Moreover, the determination of interim measures remains within the authority of the arbitrators during the arbitration, but a request must be made to the court if enforcement of these measures is sought.[18] A request to a court for an interim measure prior to the institution of the arbitration does not represent a waiver of the arbitration, nor does it prevent the matter from being referred to the arbitrators after the court's issuance of a preliminary order, which may subsequently even be revoked by the arbitrators.[19]

11. Arbitration Centers

The law expressly acknowledges the existence of arbitration institutes, as well as *ad hoc* arbitration. There are chambers and centers operating in several locations,[20] such as those existing in São Paulo, which are frequently appointed to settle national and international disputes:

- *Câmara de Mediação e Arbitragem de São Paulo do Centro e Federação das Indústrias do Estado de São Paulo* CIESP/FIESP (cmarbitragem@fiesp.org.br or www.fiesp.org.br).
- *Centro de Arbitragem da Câmara de Comércio Brasil-Canadá* (centroccbc@ig.com.br).

12. Foreign Arbitral Awards; International Conventions

Chapter VI of the Brazilian arbitration law deals with the recognition and enforcement of foreign arbitration awards. They are enforceable in Brazil according to applicable international convention or, in the absence of such convention, according to Brazilian law. Brazil, however, has not yet ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.[21] Brazil's domestic arbitration law, however, tracks the provisions of this convention. On this basis, foreign arbitration awards have been ratified in Brazil (even if they were issued before the effectiveness of the Brazilian arbitration law, which, as adjective law, applies to current actions).[22]

With respect to the international conventions having internal application in Brazil, it is important to note that Brazil has ratified[23] the Inter-American Convention on International Commercial Arbitration.[24] This convention is effective in all countries of MERCOSUR (that is, Argentina, Brazil, Bolivia, Chile, Paraguay and Uruguay). Indeed, sixteen countries in the Americas have adopted it. This convention provides for (i) the recognition of an arbitration clause of a mandatory nature and having binding effect, whether as a clause included in the underlying agreement or agreed to in a separate document or as established through the exchange by the parties of letters or communications by telex; (ii) affording an arbitration award, which is not appealable under the applicable law or procedural rules, the same force and effect as the final judgment of a judicial body enjoys; and (iii) the application of the rules of procedure of the Inter-American Commercial Arbitration Commission in the absence of an express agreement between the parties. It must be noted that Inter-American Convention on Extraterritorial Effectiveness of Foreign Arbitration Judgments and Awards[25] is also in force in Brazil (and in all countries of MERCOSUR).[26] It applies to judicial judgments, arbitration awards (and decisions issued) in foreign jurisdictions in civil, commercial and labor proceedings. The provisions of this Convention are for the most part procedural. The Convention supplements the Panama Convention, discussed above. It should also be noted that, as among the MERCOSUR countries, the International Convention on Private Commercial Arbitration was signed in Buenos Aires in 1998, and has been approved by the Brazilian Parliament, but a decree of promulgation still needs to be issued by the President of the Republic.

13. Disputes with the State

Arbitration can be used in disputes over financial terms in agreements between the state and private-sector entities (in particular, public utility concessions). Following the doctrine of *ius imperium*, so-called regulatory clauses (that is, terms dealing with the government's regulation of such entities) may not be submitted to arbitration. The legal precedent for allowing arbitration of economic terms was a 1995 law,[27] which provided that forum and dispute-resolution clauses were essential to concession agreements, thereby expanding and clarifying the provisions of the public bidding law.[28] Use of arbitration was subsequently ratified by the judiciary in a decision of the Court of Justice of the Federal District.[29] Thus, beginning with the 1995 law, several succeeding laws have enhanced application of arbitration as a dispute-resolution mechanism in the public-private-sector context. The following are some additional examples:

- Regarding concession agreements executed by the National Telecommunications Agency (or ANATEL), a 1997 law[30] provides that these agreements are to contain a forum clause and a clause covering the extrajudicial resolution of disputes.
- Regarding concession agreements executed by the National Petroleum Agency ("ANP"), another 1997 law[31] provides for mediation and international arbitration as means for settling disputes relating to such agreements.
- Regarding concession agreements for waterway transportation, a recent law[32] mandates that such agreements contain a dispute-resolution clause requiring mediation and arbitration.[33]

C. Constitutionality of Brazil's Arbitration Law

Fortunately, the issue of the constitutionality of Brazil's recognition of the institution of arbitration is well established. Brazil's high court, the STF, has ruled in several instances that a person may waive the right to submit disputes to the judiciary. In particular, arbitration has been found not to violate Article 5, item XXXV of Brazil's Federal Constitution, which provides for the right to a judicial hearing. That constitutional provision is directed at the legislature and is intended to prevent the establishment of parallel courts, which can lead to the suppression of a citizen's fundamental right to a judicial hearing. This constitutional provision was enacted in view of a practice engaged in during the dictatorship of Getúlio Vargas. The constitutional legislature of 1946, traumatized by the excesses of that time, fashioned a constitutional safeguard precluding any

legislative initiative from diminishing the rights of the citizenry to judicial redress.

The constitutionality of Article 7 of Brazil's arbitration law has also been specifically upheld.[34] Article 7 enables a party to bring an action to compel arbitration.

In sum, after four years of judicial discussion as to the constitutionality of the provisions set forth in Brazil's arbitration law,[35] the STF has provided the legal security necessary for the effective use of arbitration in Brazil.

III. Choosing Arbitration Over Litigation

A. Special Civil Court Actions

A 1995 law[36] establishes a distinct procedure for civil matters involving certain demands of up to R$6,400.00 (U.S. $3000.00). The law also affords preferential treatment to mediation and establishes a simplified procedure for appeals. Only individuals (and thus no legal entities) may file actions before this special civil court. An arbitration agreement seldom exists in situations involving the small amounts that are covered by the special court. The law also provides that in cases involving disputes of up to R$3,200.00 (U.S. $1,500.00), the parties may appear without attorneys.

B. Consumer Disputes

Arbitration in the consumer area has not yet been addressed by the authorities, nor have incentives been provided by those offering products and services in Brazil to induce dispute resolution by arbitration.[37] Disputes in this area are either settled in special civil courts or are subject to conciliation proceedings by the consumer protection and defense agencies.

C. Labor Disputes

Arbitration is well-accepted in labor disputes, with arbitration awards issued relatively quickly (on average, within thirty days). Court actions involving labor disputes, on the other hand, can take as long as two years or longer to reach a decision in the first instance. The arbitration option is set forth, generally, in collective bargaining agreements. *Conselho Arbitral de São Paulo* (or "CAESP") (www.caesp.org.br) is active in São Paulo and administers, through agreements with employers and workers' unions, labor arbitration procedures. Since its establishment in 1999, CAESP has issued over seven thousand labor and civil arbitration awards. The awards typically involve about U.S. $1,200.00. Arbitrators often determine the release of deposits related to the Guarantee Fund for Length of Service (or "FGTS"), involving severance and insurance awards for dismissal without cause, but such awards are sometimes not recognized by the Federal Savings Bank. In the face of such resistance from the Bank, the affected parties often resort to the courts, filing writs of mandamus seeking preliminary injunctions, which can then be confirmed in final judgments.

D. Business Litigation

Not unlike the situation in other countries, litigation involving complex civil and business matters, where the financial stakes are often correspondingly high, takes, on the average, eight years to reach final judgment in Brazil. Many factors contribute to this: the number of pending actions, the number of available judges, and procedural rules that enable the filing of countless appeals (namely, more than fifty).

IV. Conclusion

Arbitration can be viewed as a way of abetting the administration of justice. Justice delayed, as the saying has it, is justice denied. The time factor, the expertise of the arbitrators in the field involved in the dispute, the confidential nature of the arbitration, the power that the parties exercise in the arbitration process over the selection of arbitrators and the procedural rules to be observed by the arbitrators: These are all factors that favor arbitration. Thus, the use of an appropriately worded arbitration clause within the context of a legal (including judiciary) framework that encourages arbitration and discourages abuses makes arbitration an efficient method for resolving differences without delay and undue difficulty.

Endnotes

1. Special appeal 616 - RJ - 890009853-5, j. 09.24.90 - Lex Case law of STF/TRF, Feb., 1991; 18:108-30.
2. Law No. 9307/96, art. 3.
3. *Id*. art. 4, § 1.
4. *Id*. art. 9.
5. *See id*. art. 10.
6. *Id*. art. 2, § 2.
7. *Id*. art. 2, § 1.
8. *Id*. art. 7.
9. *Id*. arts. 18 and 31.
10. *Id*. arts. 8 and 20.
11. *Id*. art. 8.
12. *Id*. art 28.
13. *Id*. art. 16, § 6.
14. *Id*. art. 13.
15. *Id*. art. 30.
16. *Id*. arts. 32, 33.
17. *Id*. art. 31.
18. *Id*. art. 22, § 4.
19. *See* Carlos S. Lobo and Rafael Rangel Ney, *Revogação de medida liminar judicial pelo juízo arbitral*, Revista de Direito Bancário, do Mercado de Capitais e da Arbitragem, no. 12 (April/June 2001) 357/64.

20. Law No. 9307/96, arts. 5 and 21.
21. Signed in New York on 10 June 1958. Approval of the New York convention currently rests with the Brazilian parliament.
22. *See* Contested Foreign Judgment 5.378-1 French Republic - STF - j. 03 February 2000 - Justice Maurício Corrêa - DJU 25 February 2000, Revista de Direito Bancário, do Mercado de Capitais e da Arbitragem, no. 8 (April/June 2000) at 391/94).
23. *See* Decree No. 1902 of 9 May 1996.
24. Signed in Panama on 30 January 1975.
25. Signed at Montevideo on 8 May 1979.
26. Decree No. 2411, of 2 December 1997.
27. Law No. 8987, art. 23, item XV (13 Feb. 1995).
28. Law No. 8666/93, art. 54.
29. Writ of Mandamus No. 1998002003066-9, 18 May 1999, in which the court stated that by virtue of Law No. 8666/93, art. 54, administrative agreements are to be construed in accordance with their own provisions, as well as public law provisions, and that private law principles are to be applied to them in a supplementary way, such that arbitration may be used to settle any contractual disputes.
30. Law No. 9472/97, art. 93, XV.
31. Law No. 9478/97, art. 43, X.
32. Law No. 9478/97, art. 43, X.
33. *See* Lemes, *Arbitragem na Concessão de Serviço Público — Perspectivas,* Anais do Seminário Jurídico sobre Concessões de Serviços Público, Foz do Iguaçu, 8 June 2001, (Escola Nacional de Magistratura e Academia Internacional de Direito e Economia), p. 76/80.
34. Regimental Bill of Review in Foreign Judgment no. 5206-7, Kingdom of Spain.
35. Law No. 9307/96.
36. Law No. 9099/95.
37. *See* Lemes, *Arbitragem nas Relações de Consumo no Direito Brasileiro e Comparado,* in Pedro Batista Martins *et al.*, Aspectos Fundamentais da Lei de Arbitragem Forensi, 113/41 (1999).

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General Overview of Brazilian Environmental Law

By Luiz Fernando Henry Sant'Anna

I. Introduction

The first statutory effort in Brazilian law to deal with environmental matters appears in the Brazilian Civil Code, enacted in 1916, which has provisions that prohibit the use of property whenever such use may disturb the owner or the occupants of adjacent property.

Subsequently, legislation dealing with the protection of the environment was spread out through several federal and state laws dealing with several matters related to the environment, such as the use of property, water resources, forests, animal life, mining resources and others.

The first attempt to systemize the control and regulation of environment protection occurred with the enactment of Federal Law No. 6.938/1981 and ancillary regulations. The law created certain very important substantive and procedural mechanisms, remedies and types of relief (such as the environmental class action called "Public Civil Action") to facilitate effective protection against environmental damage. This law provides for the creation of certain general principles of environmental law applicable to licensing and enforcement.

The systematic legal protection of the environment in Brazil was recognized by the Brazilian Constitution of 1988 as a right of all, imposing responsibilities on both the state and the public to protect the environment. Following the 1988 Constitution, many important federal and state laws were enacted, most notably the federal law regulating criminal offenses resulting from practices that cause harm to the environment.

The purpose of this article is to present a general overview of the framework of environmental law and principles under Brazilian law.

II. The Organizational Structure of the National Environmental System

The "National System for the Protection and Enforcement of the Environment" was created by Law No. 6.938/81, and comprises the following governmental bodies:

- **National Environmental Council or "CONAMA"** (***Conselho Nacional do Meio Ambiente***) – The main objective of CONAMA, which is the National Council for the Environment, is to deliberate, within the scope of its competence, about rules and standards that are essential to public health and safety and that are compatible with an ecologically balanced environment, and to support, study, and propose to the Ministry of the Environment (see below) governmental policy relating to the environment and natural resources.
- **Ministry of the Environment, Water Resources and the Legal Amazon Region** (***Ministério do Meio Ambiente, dos Recursos Hitricos e da Amâzonia Legal***) – The Ministry of the Environment supports the President of the Republic in the formulation of national policy and governmental objectives concerning the environment and natural resources. This Ministry oversees the Institute of the Environment and Natural Renewable Resources (*Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis*) or "IBAMA."
- **IBAMA (*Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis*)** – The Institute is an executive agency at the federal level, and has jurisdiction over the licensing of activities with regional impact that involve more than one state. These activities involve projects of national interest, such as hydroelectric power plants, nuclear power plants, and the like. IBAMA works very closely with state environmental agencies, and it is these well-structured state agencies that carry out inspections, permitting and the like.
- **State Environmental Agencies** handle the licensing of industrial enterprises, as well as any other activity that may affect the environment. They also investigate complaints of any reported environmental pollution or other damage and conduct inspections. Considered as the most developed state due to its great concentration of industries, São Paulo has the fifth largest environmental agency in the world. CETESB (*Companhia de Tecnologia de Saneamento Ambiental*) , the state environmental agency of São Paulo, has over 2,200 employees, among them a significant number of highly qualified and well-trained technicians and environmental engineers.
- **Municipal Agencies** exist only in the larger cities and generally handle the licensing of municipal public projects.

III. The Statutory and Regulatory Scheme; Strict Liability

A. Statutory Framework

1. Federal Constitution

To ensure an ecologically balanced environment, Brazil's Federal Constitution sets forth the following.

- Every work or activity with a potential for substantial degradation of the environment can be undertaken only after the submission and approval of a public environmental impact report.
- Sites at which mining activities are carried out must be restored or remedied in accordance with technical specifications discussed with the appropriate environmental authorities.
- For the preservation of the environment and natural resources, the Amazon Forest, the Atlantic Forest, the Swampland (i.e., the lowlands of Mato Grosso and the Coastal Zone) are considered part of the national patrimony, such that they can be used only as the law directs.
- Nuclear power plants are to be located as provided by federal law.

2. Federal Statutes and Regulations

As noted above in the Introduction, the Brazilian Civil Code, enacted in 1916, was probably the first legal statute in the country with a provision related to an environmental issue.

The following are some noteworthy federal statutes affecting the environment:

- Federal Law No. 6.938/81 – National Environmental Policy Law, which sets forth the general guidelines and mechanisms for the preservation, enhancement and remediation of the environment necessary for the development of life and its sustenance.
- Federal Law No. 7.347/85 – Law of the Public Civil Action (discussed below), which created a procedural mechanism for protecting the environment.
- Federal Law No. 9.605/98 – Law of Environmental Crimes, which established criminal and administrative penalties for those in violation of certain environmental laws.
- Federal Decree No. 3.179/99, which regulates the provisions of the Law of Environmental Crimes.

3. State and Municipal Laws

State and municipal laws may also be applicable under the Brazilian federal system. Areas in which state or local law might apply are described in the course of the discussion below.

B. The Principle of Strict Liability

Civil liability for environmental damage is based on strict liability, for which no finding of fault is required.[1] Liability will be found if a causal relation is established between the industrial activity and the environmental damage. In addition to providing for indemnification or remediation of the damage caused to the environment, a party who exposes humans, animals or vegetation to environmental harm or who is contributing to an existing environmental danger is subject to a penalty ranging from one to three years' imprisonment and to fines.

IV. Permitting and Other Mechanisms for Environmental Control

The chief mechanisms used in the Brazilian legal system to control the environment are described below.

A. Permitting

1. Responsibility for Permitting

According to Brazil's National Environmental System, the permitting of potentially polluting activities is undertaken, according to the particular circumstances of the case, by federal, state or municipal environmental authorities.

IBAMA is responsible for permitting potential sources of pollution located in more than one state and in cases in which there is a conflict between the states, usually when a source of pollution is located in one state but affects another state. As already noted, the state environmental agencies handle the permitting of industrial enterprises, as well as any other activity that may affect the environment; investigate complaints in connection with environmental pollution or damage; and conduct inspections. Municipal environmental agencies exist only in the larger cities and basically handle licenses relating to municipal public projects.

For all activities that might potentially cause an impact to the environment one must obtain a prior or preliminary permit from the competent public authority. CONAMA's Resolution 237/97 lists some activities that are presumed as "potentially causing environmental damage," such as extraction of minerals, metallurgical industry, mechanical industry, wood industry, chemical industry, transport, terminals and deposit, and use of environmental resources. It is important to remark that, even if the activity is not listed by CONAMA's

Resolution 237, the public authorities might request environmental permits whenever the activity is considered as potentially harmful to the environment.

2. Three Types of Source Licensing Permits

The permit procedure for any potential source of pollution involves three consecutive steps, corresponding to the issuance of three different permits by the competent environmental agency, as described below:

(a) Preliminary Permit (*Licença Prévia*): This refers to the preliminary examination of the feasibility of the intended activity at the desired location. For example, some activities are not permitted near areas of permanent preservation, in certain hydrological basin areas, and the like. When necessary in specific cases, a preliminary permit may authorize the entrepreneur to carry out analyses and preliminary tests at the chosen site, aimed at determining the feasibility of the proposed venture. This permit usually takes from twenty to forty days to be issued.

(b) Installation Permit (*Licença de Instalação*): Based on a concrete analysis of the intended operation, an installation permit will establish the specific conditions to be complied with so as to eliminate or minimize any harm to the environment. The installation permit authorizes the construction of the production units of the venture or the conduct of the activities which triggered the requirement to obtain the preliminary permit mentioned above, pursuant to the terms and conditions approved by the state environmental agency. This permit may take approximately thirty to ninety days to be issued, depending on the complexity of the operation.

(c) Operations Permit (*Licença de Operação*): This permit authorizes the entrepreneur to operate the business. Once the operation is ready to start, the environmental authorities are informed and must send an inspector to the site to verify whether all the terms and conditions set forth in the installation permit have been complied with. If the operation is not a complex one, this permit may take thirty to sixty days to be issued. In some cases, temporary permits are issued to authorize the operation of the business. This allows the authorities to check the effectiveness of the treatment systems used on the project for effluents, emissions, and the like.

3. Environmental Impact Statements and Reports Prior to Permitting "Per Se" Activities

Certain activities are considered *per se* harmful to the environment. Examples include roads with two or more lanes of traffic; railways; ports; chemical, oil, and mining terminals; airports; pipelines; power plants; industrial complexes for production of oil, steel, and alcohol; and other activities potentially harmful to the environment.

Environmental permits for these types of activities can be issued only after an environmental impact statement ("EIS") and a corresponding environmental impact report have been submitted to the appropriate state environmental agency for approval.

In addition to describing the proposed activities, the EIS must do the following.

- Contemplate all technological alternatives (including alternative locations of the project), confronting each one with the supposition of not going forward with the project.
- Identify and evaluate systematically the environmental impacts occurring in both the installation and operation phases.
- Define the geographical limits of the areas that will be directly and indirectly affected by the impact (the "area of influence" of the project) and the hydrographic basin in which is located.
- Provide evidence that the project is compatible with governmental programs being implemented in, as well as any governmental plans proposed for, the area of influence of the project.

The Environmental Impact Report must reflect the conclusions of the EIS and must contain, *inter alia*, the following.

- The justification for and objectives of the project.
- A description of the project, area of influence, sources of energy, operational process and techniques, effluents, emissions, and the like.
- A description of the probable environmental impact.
- A description of the supposed effect of the measures to be taken to mitigate any negative impacts.

The EIS and corresponding Report constitute a public procedure and may involve public hearings for discussion of the project and its environmental impacts. The EIS and Report usually take from eight to eighteen months to finalize and be approved. However, depending on the activity, they may take up to two or three years to complete. The Environmental Impact Report must be written in non-technical language, understandable to non-experts who will have access to the document and who will discuss it at public hearings.

The authority to decide whether a given enterprise must submit an EIS rests with the state or municipal environmental agency, or both.

B. The Transfer of Permits

1. Ability to Transfer Permits

There are no general obstacles to be found in Brazil's environmental laws affecting the ability of overseas companies to acquire an operating business. Permits and licenses are not an issue in a stock acquisition deal. The transfer of ownership of the shares or quotas does not even need to be communicated to the environmental agency.

2. Stock Versus Asset Acquisition

From a Brazilian legal standpoint, there is no difference, insofar as environmental liability is concerned, between an acquisition of shares or quotas (that is, the acquisition of the legal entity) and an acquisition of assets (that is, the acquisition of an operation or ongoing business segment).

3. Transfer of Permits in an Asset Deal

If assets (rather than stock) are acquired, the acquirer will need to apply for the transfer of the permits from the former legal entity owning the operation. Indeed, according to Brazil's environmental system, environmental permits are connected with the site of the industrial or business operations. Therefore, the transfer of a business operation to a different legal entity entitles the person or entity thereafter responsible for the operation to file an application with the competent state environmental agency for the transfer of the environmental permits to the new legal entity. Prior to approving such a permit transfer, however, the environmental authorities will inspect the site to ensure that the permits reflect actual operations; that no building has been expanded or production capacity increased; and that no new activities or operations have been added without the necessary additional permits. The environmental authorities will also verify whether the business operation is in compliance with the conditions set forth in the operating permit. If the business operation is being conducted in accordance with the permits, the permits will be transferred.

Attorneys or technical consultants handle the application for the transfer of permits upon a transfer of ownership of a business operation. In fact, consultants usually prepare the application, with the assistance of attorneys.

C. The Green Protocol and Similar Agreements

1. The Ten Principles

Brazil's federal government is encouraging private banks operating in Brazil to adhere to the so-called "Green Protocol," which comprises several principles that must be followed in furnishing credit to projects in accordance with the concept of sustainable development.

The general principles of sustainable development set forth in the Green Protocol are as follows.

1. The protection of the environment is an obligation of all those who wish to improve the quality of life on the planet, and is not subject to any time or geographical limits.
2. A dynamic and versatile financial sector is fundamental to sustainable development.
3. The banking sector should increasingly prioritize the financing of projects that are less harmful towards the environment and exhibit the characteristics of sustainability.
4. Environmental risks should be considered in the analysis and conditions of funding.
5. Environmental management requires the adoption of practices that anticipate and prevent any deterioration of the environment.
6. The participation of clients is indispensable for the execution of the environmental policy of the banks.
7. Compliance with applicable provisions of environmental laws and regulations is mandatory, and the banks should participate in their promotion among their clients.
8. The execution of environmental policy by the banks requires the establishment and training of specialized teams within their staff.
9. Waste minimization, energy efficiency and the use of recycled materials are practices that should be stimulated at all operational levels of the banks.
10. All financial institutions should be committed to these principles.

This protocol has been agreed to by the Bank of Brazil, the Federal Savings Bank, the Bank of Northeast of Brazil, the Bank of Amazon, and the Economic and Social National Development Bank, all of which are government banks. Brazilian private banks have not yet signed the Green Protocol, but private banks do have a policy requiring compliance with certain environmental standards as a condition to financing the acquisition of legal entities or assets. Due to the high cost of money in Brazil, however, it is not at all common for such acquisitions to be financed locally.

2. BNDES Resolution

The Economic and Social National Development Bank or "BNDES" (*Banco Nacional de Desenvolvimento Econômico e Social),* far before the execution of the Green Protocol, issued Resolution No. 665/87, establishing certain requirements applicable to all agreements executed with BNDES. Chapter VI, Clause 4, item X of the Resolution provides that it is a general obligation of the beneficiary to comply with the environmental requirements of BNDES, as well as those of federal, state and municipal authorities.

3. PROCOP

The Bank of the State of São Paulo has a financing line with the World Bank Program for Pollution Control, called PROCOP, for implementation of systems for pollution control and the remediation of degraded areas. This financing provides lower interest rates, as well as certain grace periods, and a favorable term. The financing must have the prior approval of the São Paulo state environmental agency, CETESB.

D. Restrictions on Financing and Tax Incentives

Restrictions imposed by the environmental laws in regard to financing and tax incentives are not tied to the acquisition of an operation, but rather to the permitting of the operation and compliance with environmental regulations.

For example, article 12 of Federal Law No. 6.938/81, which deals with Brazil's National Environmental Policy, states that governmental financial entities, as well as governmental agencies offering incentives, must condition approval of projects qualifying for financing or for incentives on the permitting of the project and full compliance with the rules, criteria and standards established by Brazil's National Environmental Council, CONAMA. These governmental entities and agencies must clearly delineate in the project requirements what measures will need to be implemented and what equipment will need to be acquired to control environmental deterioration and to improve environmental quality. If the recipient of any such tax benefit or financing fails to undertake such measures, that party may be required to forfeit all or part of the tax benefits, or all of the incentives, granted by the government or may be subject to a suspension of such incentives. Such penalty would be in addition to any civil or criminal penalty such conduct otherwise entails.

A more recent provision, Paragraph 8 of Article 72 of the Federal Law No. 9605/98, states that penalties include the forfeiture or restriction of tax incentives or other benefits and the forfeiture or suspension of participation in any financing offered by official credit institutions.

Article 21 of State Law No. 9.509/97, which deals with environmental policy in the State of São Paulo, provides that, if the activities of installation or operation of any business deemed a source of pollution are started before the respective environmental permits are granted, the officers of the environmental agency in charge of issuing such permits must take the necessary measures to stop such installation or operation, seek judicial relief, if necessary, and communicate that fact to entities that are financing the project.

E. Other Mechanisms for Environmental Protection

In addition to the methods described above, Brazil's National Environmental Policy includes the following important means of enforcing the environmental laws and protecting the environment.

- Incentives for the production and installation of equipment and the development or implementation of technology focusing on the improvement of the environmental quality.
- Creation of territories specially protected by federal, state and municipal public authorities (such as areas of relevant ecological interest and areas containing mineral reserves).
- Disciplinary and compensatory penalties for noncompliance with measures necessary for preserving the environment or remediating environmental degradation.
- Establishment of a technical registry of activities that are potentially polluting and of permitted users of environmental resources.

V. Environmental Due Diligence

A. Due Diligence: Not Legally Required, but Strongly Recommended

The regulations themselves do not require a buyer to conduct any "due diligence" review before acquiring a business operation. In practice, however, due to the liability imposed on the buyer under the principle of strict liability, due diligence can only be strongly recommended. As noted above, this strict liability requires a polluter to indemnify against or remediate the damage caused to the environment or to third parties affected by its activity, regardless of actual guilt on the part of that polluter. Thus, an environmental due diligence review should be conducted at the site of the business operation prior to the submission of any offer to acquire that operation. The due diligence review should consist of the verification of all licenses and files of environmental documents that may reflect the state of relations between the business operation and the environmental

agencies to which the operation is subject. In addition, at least a "Phase I" environmental audit should be carried out at the site in order to identify potential or actual problems. If problems are uncovered, a "Phase II" audit should be conducted to measure the extent of the problems and to identify possible methods of remediation. Matters discovered by the buyer during such due diligence review or audits are commonly used as leverage for obtaining concessions from the seller. If, for instance, the environmental due diligence review reveals that the system for treatment of effluents was not working efficiently and needed to be improved, the buyer might require from the seller a reduction in the sale price in an amount necessary to cover such improvements.

B. Remediation Agreement with Environmental Agency ("Term of Adjustment of Conduct")

After settling with the seller on a reduction in the purchase price so as to have the funds necessary to finance remediation work and/or to finance necessary improvements to avoid future environmental liability, a purchaser frequently enters into an agreement called a "Term of Adjustment of Conduct" (*Termo de Ajustamento de Conduta*) (discussed in more detail below) with the appropriate state environmental agency and with the district attorney in charge of the environment. Such an agreement contains full disclosure of the environmental damage (or the deficiency of the treatment system or the like); the proposed remedial measures to be taken by the purchaser; and a time schedule for accomplishing the work. By taking the foregoing steps, a purchaser acquiring a business can be afforded some protection against the environmental liability to which such a purchaser might otherwise be subject.

VI. Remedies

A. Obligation to Indemnify

There are few judicial precedents concerning the duty of a party to pay for the remediation of environmental damage.

In September of 2001, in a civil action commenced by the public prosecutor, a lower court of the Second Civil Jurisdiction of the City of São Vicente ordered the payment of approximately $8 million to the State Fund for Environmental Restoration with respect to the contamination of five sites in the city of São Vicente.

In 1992, a state-owned company in São Paulo was ordered by the First Civil Jurisdiction of Pereira Barreto, in the State of São Paulo, to pay to the State Fund for Environmental Restoration the amount of approximately $200 million for damages to flora and fauna after the company installed a hydroelectric power plant on the Tiete River in the State of São Paulo. Later in 1995 the Fifth Chamber of the São Paulo State Court of Justice reversed the decision of the court of first instance.

In another case, one of the largest private industrial groups in Brazil had obtained an installation permit for a hydroelectric power plant in the State of Paraná. The license was revoked by an injunction granted by the Eleventh Civil Jurisdiction of Curitiba in a civil action commenced by a federal public prosecutor on the ground that there had been irregularities in the granting of the license.

B. Public Civil Action

In a "public civil action," a court order may be sought requiring a polluter to make a cash payment or requiring the polluter to do something or to refrain from doing something. A public civil action may be commenced by a public prosecutor, the federal government, a state or municipal government, a public company, a foundation, or an environmental association duly organized and existing for at least one year prior to the action.

If an environmental association commences a civil action and subsequently abandons the case, the public attorney is substituted for the plaintiff.

A plaintiff association will not be liable for any court costs, attorneys' fees (including the fees of experts), or any other expense, except if the association is proved to have litigated in bad faith. If an association brings a public civil action in bad faith, the association and the director responsible will be held jointly liable for payment of an amount equal to ten times the judicial costs and for any losses and damages sustained by the defendant.

C. Class Action (*Ação Popular*)

Article 5, LXXII of Brazil's Federal Constitution provides that "each and every citizen is a proper party for bringing a class action that aims at voiding an act harmful to the overall community or to an entity of which the state is a part . . ., the environment and the historic and cultural heritage, and such plaintiff is exempted from the payment of judicial fees and costs, except when acting in bad faith."

D. Collective Rights: Writ of Mandamus

Prior to the adoption of the Federal Constitution of 1988, the writ of mandamus could only be filed by an individual. After the adoption of the Constitution, not only individuals but also associated entities, political parties, and unions were empowered to file the writ. Today, all of the foregoing entities may file the writ on behalf of "trans-individual" interests. This affords protection not only to "collective interests" but also to certain categories of interests relating to the quality of life,

referred to as "diffuse interests," of which environmental protection is one of the most important.

After the adoption of the 1988 Federal Constitution, the Collective Writ of Mandamus can be filed not only on behalf of individual or collective interests, but also on behalf of diffuse interests, such as environmental issues.

E. Direct Action Regarding the Unconstitutionality of a Law

According to Articles 102 and 103 of the Brazilian Constitution, the proper parties to an action to determine the constitutionality of a law are the Brazilian Bar Association's Federal Council and union confederations, as well as class entities or institutions of national scope. Such an action seeks a finding that laws or ruling acts are contrary to general or environmental principles protected by the Constitution.

F. Remedial Plan: "Term of Adjustment of Conduct" (*Termo de Ajustamento de Conduta)*

Environmental problems may expose a company and its managers to civil penalties and other civil sanctions, as well as to criminal sanctions. A company that is aware of the existence of an environmental problem and does not immediately disclose the situation to the appropriate environmental authorities risks the imposition of increased penalties and harsher sanctions.

In cases of environmental accidents, soil contamination, air emissions, liquid effluents, and the like, it is recommended that a detailed study (conducted with the assistance of environmental consultants) be undertaken for purposes of finding possible solutions to correct the problem and to restore the environment to its prior condition when possible, or to minimize or mitigate the environmental damage. Such a detailed study should be undertaken after a preliminary study of the factual situation has been conducted to identify the problem and its legal consequences.

After the detailed analyses are completed, the proposed remediation or other solution is then typically discussed with the state environmental agency having jurisdiction over the operations at issue. The goal of such discussions is to elicit the support of the state environmental agency for the remedial actions proposed and to obtain the agency's approval of a timetable for completing the remedial work. After the support of the state environmental agency is obtained, the matter is then discussed with the environmental district attorney, and a document called a "Term of Adjustment of Conduct" (*Termo de Ajustamento de Conduta*) is negotiated and ultimately entered into by representatives of the company, the state environmental agency and the environmental district attorney.

By entering into a Term of Adjustment of Conduct, a company can substantially reduce (and in most cases eliminate) its exposure to criminal liability in connection with the matter and can also thereby preclude any further action on the part of the state environmental agency, as well as any civil action requiring the company to pay monetary damages.

G. Criminal Liability of Legal Entities: State Law No. 9605/98

State Law No. 9605/98 introduced an entirely new concept by imposing criminal liability on legal entities. Traditionally, the criminal code imposed criminal responsibility only on individuals. Thus, in the case of crimes committed by a legal entity, criminal liability was imposed on individuals, that is, on the directors and managers (including members of technical and advisory councils) responsible for the act or omission that resulted in the criminal violation.

Under the new law, a legal entity will be held liable under administrative, civil and criminal laws whenever such a law is violated as a result of the decision of a legal or contractual representative of the entity or of any of its constituent bodies, made in the interest or for the benefit of the legal entity. Moreover, the imposition of such liability on the legal entity does not affect the liability of the individuals involved, who will also be personally liable for their acts or omissions. If necessary, the authorities may pierce the corporate veil and disregard the legal entity whenever it constitutes a barrier or obstacle to the recovery of environmental damages.

Penalties other than imprisonment will be imposed in the following circumstances: (a) where the crime is unintentional or the penalty of imprisonment that would otherwise apply is less than four years; and (b) where a penalty other than imprisonment is deemed sufficient to redress the crime in light of the level of culpability and prior record and background of the guilty party, as well as the motive and circumstances of the crime. If a penalty other than imprisonment is imposed, the duration of such penalty will be for the same period of time for which the term of imprisonment would have been imposed.

The penalties imposed in such cases include the following: (a) community service; (b) the temporary interdiction of certain rights; (c) the partial or total suspension of activities; (d) the payment of a cash contribution; and (e) confinement at home.

Community service requires the convicted party to work without compensation in public parks and gardens and conservation units, or, in situations where pri-

vate or public property has been damaged, to actually participate in the remedial work, if possible.

Temporary penalties that include an interdiction of rights prohibit the violating party from contracting with the government, receiving tax incentives and other benefits, and participating in public auctions. The duration of such a penalty is five years in cases of intentional crimes and three years in cases of unintentional crimes.

The suspension of business activities will be ordered if such activities are not in compliance with applicable regulations.

Cash payments involve the payment of money to the victim or to a private or public entity having a social purpose. The amount of payment is established by the judge and may not be lower than the minimum wage for one day's worth of labor nor higher than the minimum wage for three hundred sixty days' worth of labor. Any such amount paid by the convicted party will be deducted from the amount of any damages that party is required to pay as a result of a civil action.

Confinement at home is essentially a self-imposed penalty and entails a sense of personal responsibility of the convicted party, who—without being under surveillance—must work, attend courses, and engage in authorized activities, remaining restrained on holidays and during non-working hours at his home or other regular place of residence, as established in the court order.

The following circumstances may mitigate the penalties to be imposed: (a) the party's low level of education; (b) the party's contrition, evidenced by his spontaneous remediation of the damage or substantial limitation of the environmental degradation caused; (c) the party's having publicly communicated the fact of imminent danger of environmental degradation; and (d) the party's collaboration with the agency in charge of inspections and environmental control.

The following circumstances may result in an increased penalty (to the extent they do not themselves constitute the crime): (i) recidivism involving environmental crimes; (ii) premeditation; (iii) seeking a pecuniary advantage; (iv) forcing a third party to participate materially in carrying out the violation; (v) gravely affecting public health or exposing it to grave danger; (vi) causing ancillary damage to the property of third parties; (vii) affecting areas of conservation units or areas subject to a special regime of use; (viii) affecting urban areas; (ix) causing danger to the fauna; (x) committing the violation on Sundays or holidays; (xi) committing the violation at night; (xii) committing the violation in times of drought or flood; (xiii) causing harm to a specially protected territory; (xiv) using cruel methods for killing animals; (xv) using fraud or abusing a confidence; (xvi) abusing the rights established by license, permit, or environmental authorization; (xvii) engaging in the unlawful act on behalf of a legal entity maintained totally or partially with public support or with tax incentives; (xviii) affecting threatened species listed in official reports of the competent authorities; or (xix) engaging in the unlawful conduct with the help of a public servant in the exercise of his or her official functions.

As noted above, penalties other than imprisonment may be imposed only if the term of imprisonment that would otherwise apply is less than three years.

Expert testimony will be heard to determine the extent of the harm done to the environment, so as to fix the appropriate amount of damages for purposes of setting bail and calculating the penalty.

To summarize, the penalties that can be imposed, solely, cumulatively or in the alternative, on legal entities are the following.

- The payment of a monetary penalty.
- Restrictions on rights.
- Community service.

The rights of such entities may be restricted by imposition of the following.

- A total or partial suspension of activities.
- A temporary interdiction of the industrial facility, work or activity.
- A prohibition against contracting with governmental authorities, as well as the suspension of governmental subsidies.

The interdiction will take place when the industrial facility, work or activity is being operated or conducted without the necessary authorization, in violation of the authorization granted, or in violation of applicable regulations. The prohibition against public contracting or against public subsidies or other incentives can be imposed for a term not exceeding ten years. Community service rendered by a legal entity consists in (i) sponsoring and supporting environmental programs and projects; (ii) the performance of work to restore degraded areas; (iii) the maintenance of public spaces; and (iv) contributions to environmental and public cultural entities.

Finally, any legal entity that is organized or used for the purpose of allowing, facilitating, or covering up environmental crimes is subject to liquidation, with its

assets deemed an instrumentality of the crime and thus subject to confiscation for the benefit of the National Imprisonment Fund.

VII. Conclusion: Perspectives on Developments Involving Deregulation and Voluntary Controls in Brazilian Environmental Law

Brazilian law does not contemplate incentives for environmental protection, nor does it contemplate adoption of the Eco-Management and Audit Scheme (EMAS), established by the European Union, or of ISO 14000, established by the International Standards Organization (ISO). However, the environmental authorities look favorably on companies that obtain ISO 14000 certification, because such certification implies that the company is especially concerned with the environment and is in compliance with environmental laws.

Perhaps a sign of future deregulation is the fact that certain environmental authorities (especially CETESB, in the State of São Paulo) are informally providing incentives to industrial companies that adopt self-monitoring procedures, pursuant to which such companies regularly monitor their emissions, as well as the effectiveness of the equipment used to prevent or mitigate polluting effects, and regularly take samples for analysis by private laboratories that stand in high repute with the environmental authorities.

The results of such voluntary environmental self-monitoring and controls would be furnished to the authorities on a regular basis. This kind of voluntary self-monitoring program would engender a close working relationship between the self-monitoring companies and the environmental authorities.

At the federal level, there is a bill pending in the Brazilian Congress since 1992[2] that would obligate public and private companies that may potentially cause pollution to submit every two years to an environmental audit for the purpose of verifying compliance with the environmental laws, regulations and technical requirements. Several states already impose such an audit obligation. The audit would be carried out by individuals or legal entities duly authorized by environmental authorities.

Endnotes

1. Law No. 6.938/81, Article 14, Paragraph 1.
2. Bill No. 3162.

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American and Swiss Anti-Money-Laundering Laws in Light of September 11

By Susan Weerasinghe and Juerg Kaempfer

I. Introduction

As a result of the recent events in New York, Washington, D.C., and Pennsylvania, the trafficking and retaining of illegally received money has taken on a new relevance: money laundering[1] has become the most significant economic phenomenon of organized crime and terrorism. Soon after President George W. Bush announced his global fight against terrorism, it became clear that, for the fight to be effective, terrorists would have to be drained of their monetary resources. The President therefore signed into law the "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act" ("USA Patriot Act") on 26 October 2001.[2] Its Title III contains the "International Money Laundering Abatement and Anti-Terrorist Financing Act" of 2001 (the "Act"), which profoundly expands existing U.S. anti-money-laundering laws.

II. Overview of the U.S. International Money Laundering Abatement and Anti-Terrorist Financing Act

A. Generally

The Act is far-reaching in scope, covering a broad range of financial activities and institutions. It focuses, in particular, on mandatory internal compliance programs, broader application of reporting requirements, provisions to reach foreign nationals and foreign financial institutions, and forfeiture provisions. The Act is designed as a framework law, meaning that only a few requirements take effect immediately and without the issuance of regulations. Most provisions, however, must be implemented through regulations that will be promulgated by the U.S. Department of the Treasury ("Treasury"). Treasury must therefore collaborate and consult with other regulatory agencies.[3]

B. Identification Requirements

The general thrust of the Act is a series of "special measures" that may be imposed by Treasury at any time upon the finding of "primary money laundering concern." If implemented, these special measures will require domestic financial institutions to provide information on beneficial owners of accounts and on participants in payable-through,[4] correspondent[5] and private banking accounts, even though such persons are outside the United States. In the case of private banking accounts (with minimum assets of $1 million) or correspondent accounts involving non-United States persons, Treasury's duties go further. It must issue regulations by 24 April 2002 requiring financial institutions to establish special due diligence programs[6] to detect and report money laundering, regardless of whether it finds a "primary money laundering concern." In addition, financial institutions are prohibited from establishing or maintaining correspondent accounts in the United States on behalf of shell banks that do not have a physical presence in any country.[7]

C. Extended Scope, Modified Know-Your Customer Rules and Reporting Duties

The Act significantly expands the scope of already existing statutes, including, most importantly, the Bank Secrecy Act. It extends the definition of financial institutions to cover credit unions, futures commission merchants, commodity trading advisors, and commodity pools. As an immediate measure, financial institutions must themselves establish minimum internal anti-money-laundering programs[8] by 24 April 2002. Treasury is required to issue by 26 October 2002 stricter know-your-customer rules in connection with opening an account, defining minimum standards for financial institutions. The Act also extends the Bank Secrecy Act with respect to the filing of "suspicious activity reports" (SAR). Thus, Treasury must issue regulations applying SAR requirements to registered broker-dealers after consulting with the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System (the "Fed"). It must publish these regulations in final form by 1 July 2002. Under the Act, persons engaging in a nonfinancial trade or business must file Currency Transaction Reports with the Financial Crimes Enforcement Network regarding coins and currency receipts exceeding $10,000.[9]

D. Long-Arm Jurisdiction, Foreign Money Launderers and Forfeiture

The Act contains several provisions with regard to foreign entities. Thus, foreign banks are also included in the broader definition of financial institutions. In addition, U.S. district courts will have jurisdiction over any foreign money launderer, if there is a sufficient nexus to the United States. Process may be served according to the Federal Rules of Civil Procedure or the applicable foreign laws. Moreover, funds deposited into a foreign bank account are treated as if they were deposited in the United States, if that foreign bank has an interbank account[10] in the United States. Seizure and forfeiture of such funds are facilitated under certain circumstances.[11]

E. Further Efforts to Deter Money Laundering

The Act requires from banks and other financial holding companies a clean money-laundering record as a condition for mergers and acquisitions by such institutions in the United States. Therefore, the Fed has a duty to consider the applying companies' anti-money-laundering activities, including in overseas branches. As a further preventive measure, Treasury must adopt regulations by 23 February 2002 to encourage international cooperation and information exchange among financial institutions and authorities regarding money laundering or terrorist activities. Financial institutions are not liable under U.S. law for sharing information with one another, if they have previously notified Treasury.[12]

F. Liability and Penalties

Financial institutions and their agents are subject to civil and criminal penalties of up to $1 million for violations of certain provisions.[13] They are, however, excluded from both civil and criminal liability under domestic laws for disclosure, including SARs.[14] The financial institution may not notify the person involved in the reported transaction.[15]

G. Commentary

Since Congress imposed tight deadlines for implementation of the Act, practitioners should closely monitor these fast-moving developments.[16] There is little doubt that, from now on, financial institutions in the United States will have to review their money laundering compliance efforts.[17]

III. The Swiss Anti-Money-Laundering System

A. Generally

To complement the practitioner's expertise on money laundering in an international context, it might be helpful to introduce a civil law approach from another eminent financial center with its own extremely progressive and well-tried means to combat money laundering, namely, the "Swiss Federal Act on the Prevention of Money Laundering in the Financial Sector" (MLA)[18] of 10 October 1997.[19]

The core concept of the MLA is its extremely broad application. It encompasses any type of financial intermediary, *i.e.*, every person who on a professional basis handles money belonging to third parties.[20] Under this definition, even the exchange booth of a small hotel or an attorney[21] keeping clients' money on deposit can be subject to the MLA rules. Thus, anybody engaging in certain financial transactions in Switzerland could become a financial intermediary without being aware of it. This fact makes basic knowledge of the Swiss MLA rules useful even to foreign practitioners.[22]

B. Organization of the Swiss Anti-Money-Laundering System

In Switzerland, money laundering is subject to punishment pursuant to the Swiss Penal Code (SPC).[23] The SPC penalizes any act that impedes the identification of the source, the discovery or the confiscation of assets by a person who is aware or should be aware of its criminal origin.[24] It also penalizes the lack of vigilance required in connection with financial transactions.[25]

The MLA is supplementary to these penal provisions. In addition, it extends the due diligence obligations in financial transactions, long applicable to the banking sector, to all financial intermediaries.

Two authorities have been created on a federal level to implement, enforce and control the provisions of the MLA. The Money Laundering Control Authority (MLCA) is responsible for monitoring the non-banking financial sector. The MLCA is directly answerable to the Director of the Federal Financial Administration.

The Money Laundering Report Office (MLRO)[26] is based at the Federal Office for Police Affairs, and functions as a relay between the financial intermediary and the prosecuting authorities. The MLRO checks the validity of incoming reports received from financial intermediaries in accordance with their reporting obligation.[27]

Within its broad scope of application, the MLA distinguishes between (i) financial intermediaries that have traditionally been known as financial institutions, such as banks, investment funds, insurance institutions (under limited circumstances) and securities dealers[28] and (ii) all other persons that on a professional basis accept, keep or help invest or transfer assets belonging to third parties.[29]

The MLA defines a series of due diligence obligations regarding verification of customer identity, as well as identification of the beneficial owner. It also imposes a duty to clarify the economic background of suspicious transactions and imposes certain record-keeping measures to implement know-your-customer rules. Financial intermediaries are required to report suspicions of criminal activity and to block the assets related thereto. A financial intermediary who knows or presumes, on the basis of a founded suspicion, that assets involved in a business relationship are related to a money laundering offense, that they are proceeds of a crime, or that a criminal organization has a right to dispose of them must immediately notify the MLRO. The financial intermediary must then freeze the entrusted assets linked to the reporting. The freeze must continue until issuance of a decision by the prosecuting authority, but the freeze may not exceed five working days from the notification. Financial intermediaries who comply with the

applicable due diligence obligations are excluded from both criminal and civil liability.[30]

To ensure compliance with its provisions, the MLA imposes a tight supervisory net over all persons and institutions dealing with third-party funds. The "traditional" financial intermediaries (banks, investment funds, insurance institutions and securities dealers) are primarily organized and regulated through special federal laws.[31] Pursuant to these special federal laws, these institutions were supervised by federal commissions, most prominently the Swiss Federal Banking Commission (SFBC),[32] even before enactment of the MLA. To implement the MLA, the supervisory competence of the SFBC has been extended to encompass the new anti-money-laundering compliance requirements. In addition, the SFBC was given the authority to define further the scope of duties set forth in the MLA. It assumed this new responsibility in its "Guidelines on Combating and Prevention of Money Laundering."[33]

"Non-traditional" financial intermediaries[34] not subject to regulatory oversight by a federal commission are monitored and controlled by one of the recognized professional associations (self-regulating bodies) to which they are affiliated.[35] The MLA avoids direct supervision by the MLCA wherever possible and gives preference to self-regulation. This means that financial intermediaries are subject to inspection by an authority closely acquainted with the sector's specific problems, reflected specifically in the actual form of the due diligence requirements in transactions with clients. The self-regulating bodies are themselves licensed and supervised by the MLCA.[36] Should a financial intermediary choose not to join a recognized self-regulating body, however, the MLCA itself assumes the supervisory task.

C. The Events of September 11 . . .

On 23 September 2001, President George W. Bush signed Executive Order 13224 ("E.O. 13224")[37] to fight international terrorism. E.O. 13224 authorizes aggressive actions against the bankers of international terrorism by blocking the assets of organizations and individuals linked to terrorism. Pursuant to the E.O. 13224, twenty-seven bank accounts of individuals and organizations were immediately frozen. As of 31 December 2001, one hundred fifty-three terrorist groups, entities, and individuals were covered by E.O. 13224.

D. . . . and Their Effects on the Swiss Anti-Money-Laundering System

After President Bush asked foreign governments and banks to join him in this fight against terrorism, both the MLCA and the SFBC supported the American efforts by sending information letters[38] to all financial intermediaries and self-regulating bodies. In these letters the two authorities disclosed the identities of the suspects whose bank accounts and assets were blocked pursuant to E.O. 13224. Financial intermediaries and self-regulating bodies were specifically ordered to match the list of their clients and beneficial account owners with the names on the American list. They were also asked to report and immediately freeze any detected assets. Moreover, the information letters restated the sanctions, which, if applied, could result from not following directions or not reporting suspected business connections to the MLRO. To assist all financial intermediaries, a special information center at the headquarters of the Swiss Federal Criminal Police was created.

In collaboration with the Swiss Exchange,[39] the virt-x[40] and the Eurex[41] Switzerland, the SFBC is currently investigating possible signs of pre-September 11 insider trading that might indicate knowledge of the attacks. Therefore, the transaction in securities of Swiss insurance and airline companies, as well as specific American securities, are being scrutinized.

Upon report to control and supervisory bodies, the justice authorities, more specifically the Office of the Federal Prosecutor of the Swiss Confederation (PG), decide whether to carry out a prosecution.[42] In cases of criminal prosecution, banking secrecy is lifted. Regarding the events of September 11, the PG instituted a proceeding to assist not only the United States in its fight against terrorism but also Swiss authorities in connection with Swiss citizens who were killed in the attacks. This proceeding is investigating whether acts relevant to the attacks were committed in Switzerland, and it is helping to identify potential criminals. Because of the importance of this matter, the PG created a special task force, the "Task Force Terror USA," as a control center of the Swiss investigation and prosecution process, as well as a resource of relevant information. In addition, the Task Force maintains contact and collaborates with foreign prosecution authorities.

IV. Swiss Prevention: The Taliban Act

Almost a year before the tragic attacks, on 2 October 2000, the Swiss Federal Council adopted the Taliban Act.[43] The Taliban Act was enacted in accordance with the UN Resolution 1267 (1999)[44] to support the UN embargo against the Taliban, who refused to extradite Osama bin Laden after the 1998 attacks against the American embassies in Kenya and Tanzania.[45] It also allowed the Swiss government to implement its strict anti-money-laundering concept to fight international crime and terrorism. The Taliban Act contains a list of suspected persons.[46] In addition, it includes an armament embargo, which bans the Taliban from using Swiss airspace and imposes financial sanctions (*i.e.*, all

Taliban bank accounts are blocked and the Taliban are prohibited from obtaining loans). On 12 April 2001, the Taliban Act was revised according to the UN Resolution 1333 (2000)[47] with the following changes:

- The blocking of the bank accounts and assets of one hundred seventy persons.
- Prohibition of technical consulting, help and instruction in military education (to extend the already existing armament embargo).
- Prohibition of the export of certain chemical substances to Afghanistan.
- Extension of the already existing air traffic embargo.
- Prohibition of Ariana Afghan Airlines from engaging in business transactions in Switzerland.
- Ban on hosting diplomatic missions of the Taliban.
- The blocking of Taliban leaders from entering into and traveling through Switzerland.

V. Conclusion and Commentary

The events of September 11 have prompted the most significant overhaul of U.S. anti-money-laundering laws in decades. Contrary to the American situation, no legislative changes have been made to the Swiss anti-money-laundering system, because it was both enacted and efficiently enforced prior to September 11. For instance, in November 2000, $50 million in assets belonging to Vladimiro Montesinos, the aide of President Fujimori of Peru, were frozen. Moreover, the account of Nigerian dictator General Sani Abacha was blocked. Timely action by the Swiss authorities blocked and froze an additional $1.2 billion of criminal-related assets during the same period.[48]

After the events of September 11, it became clear that the Swiss system also works well with terrorist-related money laundering. Switzerland promptly froze thirty bank accounts containing approximately $9 million that may be linked to people and organizations involved in the attacks.[49] Banks as well as other financial intermediaries provided the necessary information to the appropriate authorities and thereby proved that they could, at any given time, trace the "paper trail."

The action of the Swiss government, prior to and following the attacks, has proven that, in terms of commitment and results, Swiss authorities are fully active and seek to achieve more. In closing, it may be safe to state that the Swiss anti-money-laundering laws are up to par with international standards. In the event that unpredictable and unethical occurrences arise, such as the terrorist acts of September 11, these laws should be able to stand up to similar challenges.[50]

Endnotes

1. Money laundering is the processing of funds generated by criminal acts to disguise the illegal origins of such funds.
2. H.R. 3162, 107th Cong. (2001), available at http://www.epic.org/privacy/terrorism/hr3162.html.
3. The supervisory letter SR 01-29 on the USA Patriot Act and the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 may be viewed at http://www.federalreserve.gov/BoardDocs/SRLetters/2001/sr0129.htm.
4. Payable-through accounts are generally checking accounts held by foreign banks that otherwise would not have the ability to offer their customers *direct* access to the U.S. banking system.
5. A correspondent account is a United States account established to receive or make deposits on behalf of a foreign financial institution.
6. These due diligence programs must be distinguished from the internal anti-money-laundering programs (see Sec. 352, 31 U.S.C. § 5318(h)) to be established by the financial institutions themselves and covering all bank transactions.
7. Sec. 311, codified at 31 U.S.C. § 5318A; 312(a) Sec. 313, and codified at 31 U.S.C. § 5318.
8. Sec. 352(b), codified at 31 U.S.C. § 5318(h). These programs include, in particular, (i) development of internal policies, procedures and controls and (ii) designation of a compliance officer.
9. Sec. 356(a), codified at 31 U.S.C. § 5318(g); Sec. 352(a), codified at 31 U.S.C. § 5318(h); Sec. 321, codified at 31 U.S.C. § 5312(2); Sec. 326(a), codified at 31 U.S.C. § 5318; Sec. 356(c), codified at 31 U.S.C. § 5318(g); Sec. 365(a), codified at 31 U.S.C. § 5331.
10. An interbank account is an account held by one financial institution at another financial institution to facilitate customers transactions.
11. Sec. 318, codified at 18 U.S.C. § 1956(c); Sec. 317, codified at 18 U.S.C. § 1956(b); Sec. 319, codified at 18 U.S.C. § 981.
12. Sec. 327, codified at 12 U.S.C. § 1842(c) and 12 U.S.C. § 1828(c); Sec. 314, codified at 31 U.S.C. § 5318.
13. Sec. 363, codified at 31 U.S.C. § 5321(a).
14. Sec. 351(a), codified at 31 U.S.C. § 5318(g)(3).
15. Sec. 351(b), codified at 31 U.S.C. § 5318(g)(2).
16. Sutherland Asbill & Brennan LLP, Client Alert, *Overview of the USA Patriot Act and of Title III (Money Laundering Abatement)*, Nov., 2001, at http://www.sablaw.com/db30/cgi-bin/pubs/patriotfinancial4pdf.pdf.
17. The following advisory has been consulted for interpretation of the USA Patriot Act: Alston & Bird LLP Advisory, *A Detailed Summary of Major Provisions in the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001*, Nov. 13, 2001, at http://www.alston.com/docs/Advisories/199709/A%20Detailed%20Summary.pdf.
18. *Bundesgesetz zur Bekämpfung der Geldwäscherei im Finanzsektor* [Swiss Federal Act on the Prevention of Money Laundering in the Financial Sector] [hereinafter "MLA"] *Systematische Sammlung des Bundesrechts* [SR] 955.0 available (in English) at http://www.admin.ch/efv/gwg/e/mla.pdf.
19. As a member of the Financial Action Task Force on Money Laundering (FATF), Switzerland had pledged to implement the FATF recommendations to prevent money laundering. The enactment of the MLA stems from this obligation.
20. MLA art. 2.
21. The attorney-client privilege covers attorney advisory services, but not services in his/her function as financial intermediary. Money Laundering Control Authority, *On the Question of Lawyers and Notaries Being Subject to the Federal Act on the Preven-*

tion of Money Laundering in the Financial Sector (MLA) and the Supervisory Activities of the Money Laundering Control Authority, at http://www.admin.ch/efv/gwg/e/zufragen.htm (last visited 8 Jan. 2001).

22. As the United States Congress works to block primarily the banks as channels for money laundering, terrorists and other criminals will look for alternatives. Lawyers could then become especially attractive targets due to the lawyer-client privilege that mandates the attorney to keep clients' secrets.

23. The full text of the *Schweizerisches Strafgesetzbuch* [Swiss Penal Code] [hereinafter "SPC"] SR 311.0 available (in German, French and Italian) at http://www.admin.ch/ch/d/sr/3/311.0.de.pdf.

24. SPC art. 305bis.

25. SPC art 305ter.

26. By assessing the reports sent in by the financial intermediaries, the MLRO detects cases of money laundering suspicion, thus conducting an efficient preliminary examination for the prosecuting authorities. It also analyzes situations of risk, and furnishes reliable information to financial intermediaries, supervisory bodies, and prosecuting authorities. For more details consult http://www.bap.admin.ch/e/themen/geld/i_index.htm

27. More details are available at http://www.admin.ch/efv/gwg/e/kurzrefe.htm.

28. MLA art. 2 par. 2.

29. MLA art. 2 par. 3.

30. MLA art. 3-11.

31. The Banking Act regulates banks, the Act on Investment Funds regulates investment funds, the Act on Insurance Supervision regulates insurance institutions, and the Securities Act regulates securities dealers.

32. The SFBC's task initially consisted of supervising banks. Its goal was to assure the solvency of every banking institution and to protect customers. Today, the SFBC supervises banks, securities dealers and investment funds. The supervised institutions and recognized foreign exchanges may be located at http://www.ebk.admin.ch/e/societe/index.htm. Insurance institutions, however, are supervised by the Swiss Federal Office of Private Insurance.

33. Full text of the *Richtlinien zur Bekämpfung und Verhinderung der Geldwäscherei* [Guidelines on Combating and Prevention of Money Laundering] *Eidgenössische Bankenkommission Rundschreiben* 98/1 available at http://www.kpmg.ch/library/attachments/tcirculars/unofficial_translation_98_1_9566242.pdf.

34. Asset managers, money brokers, bureaux de change, foreign exchange and banknote dealers, solicitors, notaries and trustees especially, but also the Swiss Post and the Swiss Federal Railways are subject to supervision under the MLA.

35. A list of the recognized professional self-regulating bodies may be consulted at http://www.admin.ch/efv/gwg/d/srolist_d.pdf.

36. The MLCA ensures that all financial intermediaries are either (i) subject to special legal supervision, (ii) SRB members or (iii) under direct control of the MLCA. Thus, the MLCA has only a subsidiary function vis-à-vis the SRBs. The MLCA is to recognize an SRB, approve the SRB's regulations, supervise the SRB, and inspect implementation of its regulations. In principle, any association is entitled to recognition as an SRB if it meets the legal requirements. The homepage of the MLCA may be located at http://www.admin.ch/efv/gwg/e/index1.htm.

37. *Executive Order 13224 Blocking Property and Prohibiting Transactions with Persons who Commit, Threaten to Commit, or Support Terrorism*, Exec. Order No. 13224 available at http://www.ustreas.gov/terrorism.html.

38. For more details consult http://www.admin.ch/efv/gwg/d/infoschr-1.htm.

39. More information regarding the SWX Swiss Exchange may be located at http://www.swx.com.

40. More information on the European blue chip exchange virt-x is available at http://www.virt-x.com.

41. More information regarding the European derivatives exchange (Eurex) may be found at http://www.eurexchange.com.

42. MLA art. 23.

43. *Verordnung über Massnahmen gegenüber den Taliban (Afghanistan)* [Taliban Act] (Switz.) SR 946.203 (in German, French, and Italian) at http://www.admin.ch/ch/d/sr/9/946.203.de.pdf.

44. May be located at http://www.mpa.gov.sg/homepage/mcp/mc01-04R2.htm.

45. For more information see the press release (in German, French and Italian) at http://www.admin.ch/cp/d/39d85471_1@fwsrvg.bfi.admin.ch.html.

46. The complete list of suspected persons may be downloaded at http://www.seco-admin.ch/seco/seco2.nsf/Atts/AWP_ExpKont_SankTalib/$file/NamenlisteTalib.pdf.

47. United Nations Security Council Resolution 1333 of Dec. 19, 2000 at http://www.un.org/Docs/scres/2000/res1333e.pdf.

48. Nick Ridley, *Money Laundering – The Wolf at the Door – The Wolfsberg Principles Were Established Last Year, but What Is the History Behind International Efforts to Provide the Rigorous Anti-money-laundering Code?* The Banker, Oct. 1, 2001, LEXIS, Nexis Library, All Sources, News, News Group File.

49. It is not clear whether these figures also include the twenty-four accounts frozen in October, all apparently related to one name.

50. Representing different newspapers, the *Financial Times* cited the MLA as "one of the strictest anti-money-laundering codes in the world" in its article of 25 September 2001. The Ambassador to the United States in Switzerland, Mercer Reynolds, stated in an interview that he was impressed by the Swiss anti-money-laundering system, the standards of which he deemed stricter than those of the American system. He also quoted the *Herald Tribune*, stating that the Swiss anti-money-laundering system is the leader in this issue. Referring to the list of people allegedly supporting terrorist activities, that was handed over to the Swiss government by the United States, Ambassador Reynolds noted that Switzerland took very swift action. *See "Die Schweiz ist bei der Kontrolle führend,"* Neue Zürcher Zeitung (Zürich, Switz.), 2 Oct. 2001 available at http://www.nzz.ch/dossiers/2001/usa/2001.10.02-al-article7OW7O.html.

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Argentine Legislation on E-Commerce

By Juan Martin Arocena

I. Introduction

There are currently no laws in Argentina that address directly e-commerce transactions, with the exception of certain special laws such as the Consumers Act referred to in Part IV below and the Privacy Act referred to in Part VIII below. However, the government is in the process of drafting or adopting several pieces of legislation.[1] In the meantime, traditional laws would be applied to any disputes involving Internet-related transactions.

The application of traditional laws may create problems, since those laws cannot easily be applied to Internet transactions. Indeed, rapid changes in telecommunications have resulted in practices that are vastly different from those contemplated by the legislators when drafting the existing legislation. For instance, some agreements require handwritten signatures.

II. Regulated Areas of E-Commerce

The lack of e-commerce legislation does not mean that online transactions are exempted from the application of the existing laws and regulations applicable to the trade involved. Thus, existing laws and regulations must be carefully analyzed on a case-by-case basis.

A. Securities Regulation

Securities laws apply to online brokers and offerings. The Argentine Securities Exchange Commission (CNV) allows mutual funds to trade their portfolio online, provided they file a description of the marketing system and the safety and backup procedures.[2] Potential investors are to receive by mail the prospectus and open an account either personally or by e-mail. In the latter case, the signature must be certified by a notary. Argentine securities regulations apply to online offerings to Argentine residents of foreign securities not listed in Argentina.

B. Auctions

Since typical "auction" sites do not perform auctions in the way that that activity is defined by applicable law and regulations, they do not need to comply with such law and regulations. Nevertheless, in order to avoid eventual confusion and potential claims of using misleading information under consumer legislation, "auction" sites should clearly indicate that they do not perform auctions, as the term is defined by applicable law and regulations.

C. Tourism

The sale or marketing of tourist services via the Internet is subject to the traditional laws that regulate tourist services.[3]

D. Online Banking

There are currently no specific provision regarding online banking.

III. Domain Names

A. Registration of Domain Names

NIC-Argentina[4] is the registrar of the Argentine domain names.[5] Any person interested in obtaining an ".ar" domain name must file online a sworn affidavit. Domain names are granted free of charge to the first applicant for a one-year period and are subject to renewal.[6] NIC-Argentina may prevent the registration of domain names that may cause confusion with corporations or with an individual's famous name, and may prevent the registration of domain names that are immoral.

Since the registration of domain names is free of charge and relatively few specific requirements are asked for the registration, Argentina is currently the sixth-ranked country in the world[7] in terms of the most domain names registered.[8]

Following WIPO's recommendations, and in order to counter the problem of cybersquatting, NIC-Argentina recently requested more accurate and reliable contact details from registrants.[9]

B. Domain Names vs. Trademarks

Argentine courts have allowed certain trademark owners to trump a private domain name registrant and oblige the registrant to assign the domain name to the trademark owner.[10] In *Heladería Freddo S.A. v. Sport Network,*[11] Heladería Freddo successfully restrained an individual from using an identical domain name registered by the latter. It was held that the owner of a trademark has also the right to use it in order to sell its products via the Internet.[12]

The *Freddo* case should be a deterrent to potential squatters, since any person who deliberately registers a domain name identical to the trademark of an unconnected, well-known company for commercial gain must expect to find itself on the receiving end of an injunction.

Notwithstanding the foregoing, there is currently no case law concerning claims of trademark or trade names owners against holders of confusingly similar, albeit not identical, domain names, nor against bona fide holders of identical or similar domain names.[13]

IV. Consumer Legislation[14]

Consumer legislation applies *inter alia,* to the following aspects of click-wrap agreements:[15]

A. The Offer

Any offer addressed to the public at large is binding on the offeror. The offer must clearly state its expiration date as well as its terms and conditions. Offerees are to receive accurate detailed and efficient information on the main features of the goods or services provided accurately and objectively. Unconscionable provisions and disclaimers of offeror's liability or restrictions to offeree's rights are void, and opt-out provisions are restricted.

B. Withdrawal of the Offer

Any offer made via mail, phone or the Internet must specifically indicate that the offeree may withdraw the acceptance within five days after the execution of the agreement, or the reception of the product. The return expenses are to be borne by the offeror.

C. Warranty

All durable goods sold to consumers must have a three-month warranty against any kind of defects, running from delivery date. The warranty may not be waived.

Within thirty days after a certain service is provided, service suppliers must rectify at no charge any defects in the service, unless the parties specifically provided otherwise in writing.

D. Advertisements

Advertisements are not to be misleading and are deemed to be a part of offeror's subsequent contract with offeree.

E. Breach of Contract

If the offeror does not comply with the offer or the contract, the offeree may either demand specific performance, accept another good or equivalent service, or terminate the agreement. The offeree is entitled to claim for reimbursement of paid amounts and for damages. Investigations may be carried out *ex officio* by the regulator or at the request of an adversely affected individual or entity.

V. Electronic Contract Acceptance

In the absence of a digital signature law, general principles and rules regarding contract law, as provided in the Argentine Civil Code and the Argentina Commercial Code, apply to electronic contract acceptance.

A. Validity and Evidence of Click-Wrap Agreements

Although the Argentine Civil Code provides that those agreements which must be entered into in writing must bear a handwritten signature as an essential condition for their existence, the issue boils down to proving the existence of the contract. In the absence of a document bearing the signature of the obligee, the existence of such contract may be proved by other means of evidence only if (i) the party that invokes the contract has performed its obligations thereunder or (ii) there are other documents prepared or signed by the obligee or by a third party, related to the purpose of the agreement.

B. Acceptance by an Offeree that Is Not Present when the Offer is Made

If the offeree is not present when the offer is made—for instance, when the offer is sent by an electronic mail—the contract is concluded when the acceptance to the offer is sent, provided the acceptance is not revoked before the acceptance is known to the offeror or the offeror does not die or lose his or her legal capacity before knowing of the acceptance.[16] In this case the offer can only be revoked by the offeror before conclusion of the contract takes place.[17]

Acceptance can be either explicit or through conduct.[18] Mere silence, however, does not impose any binding obligations upon the offeree, except in such cases where there is already a legal duty to explain or whether there is a connection between the present silence and the previous statements.[19] Moreover, as indicated in Part V.A. above, the CPA specifically prevents opt-out clauses.

The offeree may withdraw the acceptance before it is known to the offeror.[20]

C. Acceptance by an Offeree that is Present when the Offer is Made

Some commentators consider "click-wrap" agreements to fall within this category. In these cases, the rules indicated in Part V.B. above do not apply, since the contract is closed as soon as the offeree accepts the offer made when he was "present."

D. Consumer Legislation

The consumer legislation provisions concerning the offer, withdrawal, warranty and advertisement mentioned in Part IV are applicable to click-wrap agreements.

E. Damages

An offeree that accepts an offer before knowing of its withdrawal by the offeror, or upon hearing of the offeror's death or legal incapacity, is entitled to claim compensation for losses and expenses.[21]

The withdrawal of acceptance by the offeree after it was known to the offeror entitles the latter to claim compensation for losses and lost profits, if the contract—which has already been concluded—cannot be performed.

VI. Digital Signature

Although currently no digital signature law has been adopted,[22] six different bills are currently being considered by the Argentine Congress.

The first bill was prepared by the Ministry of Justice based on the method of asymmetrical cryptography[23] proposed by the Utah Act in the United States. It provides for a private password for the signature encryption and a public password for its decodification, as well as a certificate of public passwords for every signature issued by a public password comptroller.

The three latest bills[24]—following the new trend—are technology-neutral and have a minimalist regulatory approach in order to allow electronic commerce to develop in the private sector without constraints. The bills provide for, *inter alia*, (i) statutory recognition of the validity of digital signatures and electronic records, (ii) a voluntary recognized certification authority scheme whereby a digital signature is only given legal recognition if it is supported by a certificate, and (iii) rules for the creation of electronic contracts.[25] Digital signatures are given the same status as handwritten signatures, provided they are supported by a certificate. Electronic records and digital signatures are given similar legal status to that of their conventional paper-based counterparts. "Electronic records" is defined and its admissibility in evidence set out.

VII. Liability of Intermediaries, Sellers and Internet Providers

A. Liability of Intermediaries

Pursuant to the Consumer Protection Act, manufacturers, importers, agents, distributors, suppliers, sellers and carriers are jointly and severally liable for any damages resulting from product liability or lack of compliance with their duties.[26] These liabilities cannot be waived. Although one party may contractually indemnify the other, the indemnity is not valid vis-à-vis third parties.

B. Liability of Internet Service Providers

There are no specific regulations or precedents concerning the liability of ISPs.

Although there are no precedents, one could predict that a court would uphold a claim against an ISP only in the event of gross negligence, since the Internet was granted rights similar to those granted the media by the Argentine government.

VIII. Confidentiality and Preservation of Electronic Data

The Argentine Federal Constitution[27] grants each individual the right to request from any public or private registry the disclosure of its personal data and the reason why the data were collected. An individual can also request the suppression, amendment, update or confidentiality of such data if the data are false or discriminatory.

On 5 October 2000, the Argentine Congress passed a privacy law (the "Privacy Act"[28]). The Privacy Act addresses, *inter alia,* the following issues.

A. Purpose

The personal data can only be used for the purpose for which they were obtained.

B. Owners' Consent

The collection, conservation, classification, amendment, co-relation with other information, processing or transfer of personal data requires the user's specific consent. The consent must be given in writing or any other equivalent form.

C. Processing of Personal Data Without Authorization of the User

The name, ID, tax ID, profession, occupation, date of birth and domicile of the user may be disclosed without requiring the consent of the user.

D. Information

Companies that collect personal data must indicate to the user why the data were collected, the identity and domicile of the registrar, whether the request of data is mandatory, and the possibility to access, amend or suppress the data.

E. Security and Confidentiality

The registrar must adopt all necessary measures to guarantee the safety and confidentiality of the personal data.

F. Professional Secrecy

The registrar and any other party to which the information is disclosed must keep the personal data secret.

G. Sensitive Data

The collection of information related to ideology, political or religious ideas or affiliations, race, racial origin, personal or sexual habits is expressly forbidden. Nevertheless, sensitive data may be used for statistical or scientific purposes, provided the information cannot be tied back to a specific individual.

H. Anonymous Data

Anonymous data may be freely transferred, used and shared in aggregate form with third parties for commercial purposes.

I. Onward Transfer

Personal data may not be transferred to countries that do not comply with adequate protection standards.

IX. Privacy

The Argentine Federal Constitution provides protection to all individuals in regard to intimacy and privacy as well as specific protection for correspondence and private documents.[29]

The Argentine Civil Code restricts the invasion of privacy and the publication of pictures and private correspondence, and prohibits hurting other persons' feelings or habits. Although there are no precedents, this provision could be applied to restrict the use of "cookies" as well as spam mail or targeted advertisement based on private data obtained without the user's authorization.

X. Taxation of E-Commerce Transactions

Generally the same tax laws applicable to traditional commerce apply to e-commerce.

A. Tax System

While resident taxpayers are subject to tax on their worldwide income, non-resident taxpayers are taxed only on their Argentine-sourced income. A tax credit system has been adopted to mitigate double taxation on resident taxpayers. Taxation of non-residents is made through income tax withholdings, which apply on a fixed presumed income basis.

Argentine resident corporate taxpayers, in general terms, are subject to:

- Thirty-five percent income tax on their net worldwide income;
- Twenty-one percent value added tax on the value of the goods sold or the services rendered;
- One percent minimum presumed income tax on the value of its assets at the end of the fiscal year;
- Three percent gross receipts tax;[30] and
- Some other miscellaneous taxes.

B. Customs Duties

The tax basis, for customs purposes, of goods imported into Argentina is the transaction value. Most imports are subject to taxes and duties.

C. Downloads

Customs regulations consider downloadable software as a "good" subject to customs duties.

XI. Intellectual Property Rights

A. Intellectual Property Protection

Argentina has long recognized intellectual and industrial property protection. The Argentine Federal Constitution provides that authors and inventors are the exclusive owners of their works, inventions or discoveries during the period set forth by the law. Federal laws such as the Trademark Act, the Invention Patents Act, the Copyright Act and the civil and criminal codes set the legal framework for intellectual property protection. Besides, Argentina officially adheres to most treaties and international agreements addressing these issues, including the Paris Conventions for the Protection of Industrial Property, the Universal Copyright Convention, the WTO Agreement and its Uruguay Round (TRIP),[31] specifically protecting patents, trademarks and copyright.

1. Trademarks[32]

Ownership and exclusive right of trademark is obtained by registration. Protection of trademarks lasts ten years and may be renewed indefinitely for periods of ten years if said trademark has been used within a period of five years prior to each renewal in commercialization of products, or rendering of service, or as part of the name of an activity.

The Trademarks Act grants every legal owner of a registered trademark an exclusive property right and prevents its use, forgery and imitation by third parties. The Act also protects: "commercial designations," such as names, signs or designations used to identify a particular activity, provided such use has been public, specific and uninterrupted for at least a year. Non-registered notorious trademarks also receive protection in Argentina pursuant to the Paris Convention.

Individuals or corporations requesting registration for a trademark in Argentina are granted a six-month priority period for the registration of such trademark in other member states under the Paris Convention.

Neither names, words nor signs given to products or services by their manufacturer describing their nature, operation or qualities, and neither names, slogans of general usage before application for registration, nor those that would produce confusion with other products, may be used as trademarks.

2. Patents and Business Methods[33]

Any invention of products or proceedings in any technological field which is novel, represents an inventive step and is susceptible of industrial application is patentable.

The Patent Law[34] provides that "rules and methods for performing . . . economical and commercial activities" shall not be considered an invention. Therefore business methods may not be patented. Neither may software programs, although, as we indicate in Part XI.A.3. below, they are specifically included within the scope of copyright protection.

3. Copyright

The Intellectual Property Act[35] protects intellectual work,[36] but not the idea itself. All intellectual works are entitled to registration with the Copyright Office by means of depositing excerpts thereof.

The layout of a web site is copyrightable, as well as sounds, images, videos, databases and other multimedia components. Moreover, software is specifically included within the scope of copyright protection.

For instruction or scientific purposes, citations of up to one thousand words—or eight bars in musical works—of the indispensable parts of literary and scientific works are allowed. Photographs of a person cannot be published without consent, except in connection with scientific or other cultural works or matters that occurred in public.

B. Deep Linking, Metatagging and Trade Secrets

1. Deep Linking

In case a link is designed to avoid or hide the content's source or its owner's ID or trademark ("deep linking"), the practice may violate the Trademark Act, the Paris Convention or the Commercial Loyalty Act. The Paris Convention[37] prohibits any confusion with a competitor's products or commercial activities and the Loyalty Act[38] sanctions any misleading advertisement concerning products or their marketing. Moreover, such practices may be penalized pursuant to the Argentine Criminal Code,[39] which sanctions anyone that tries to obtain clients from a third party with fraudulent methods or illegal advertisements.

2. Metatagging

The Metatag is a form of computer code[40] that is analyzed by the search engines but is not visible in the natural viewing layout of a web site page. Illegal use of trademarks as metatags by a third party may violate the Paris Convention, the Trademark Act, the Criminal Code and the CPA.

3. Trade Secrets

A trade secret is defined as any formula, pattern, device or compilation of information which has a commercial value while it is not known or used by third parties.

Law No. 24,766 and Law No. 24,425 protect undisclosed information under the provisions of the WTO/TRIPS Agreement.

Employees and contracting parties are not to use trade secrets without the authorization of the owner. The owner of the trade secret may request an injunction in order to prevent its disclosure and claim loss of profits and expenses to anyone infringing the law.

Trade secrets are also protected by the Criminal Code,[41] which prohibits any disclosures of a secret that may cause damages, as well as the opening of confidential documents addressed to a third party.[42]

C. Enforcement of Intellectual Property Infringement

The Trademark, Patent and Intellectual Property laws set forth, *inter alia*, the following sanctions in the event of infringement of intellectual property rights: (i) attachment and seizure of the items whereby the trademarks are being infringed; (ii) dispossession of the goods and other items bearing the counterfeited trademarks; (iii) destruction of the counterfeited trademarks and denominations and of all the items bearing such trademarks and denominations; (iv) seizure of the original works published without the authorization of the author or his/her successors; (v) seizure of edited works sold or copied omitting or changing the author's name. WTO/TRIPs[43] also provide for other summary measures to prevent the goods bearing the counterfeited trademarks from entering the market.

Notwithstanding the foregoing, software piracy is still a problem in Argentina. However, in the last few years, civil and criminal courts have taken some highly publicized and aggressive measures to enforce intellectual property laws. In 1996, the Argentine Congress passed a law that substantially strengthened patent protection, addressed infringement and extended patent duration to twenty years.

XII. Labor Law

A. Use of the Internet in the Working Environment

Employers may prevent the use of the Internet in the working environment, but may only monitor the use of the Internet if they have previously notified the employees.

B. Telecommuting

Employees that work in their home are regulated by the same labor laws as apply to those employees working in the premises of their employers. There are no specific laws governing telecommuting.

C. Content Providers

Under certain circumstances providers of content to a Web site might be considered to fall within the scope of labor legislation applicable to journalists. In that case they might be entitled to certain special benefits and higher severance payments.

Endnotes

1. Resolution 412/99 of the Argentine Ministry of Economy recommended that the respective governmental agencies adopt legislation to resolve, *inter alia*, problems arising in connection with

user's privacy, trademarks and domain names, safety of online transactions, digital signature and electronic documents, jurisdiction and tax issues. The Model Law of UNCITRAL, which establishes guidelines to overcome some of the legal obstacles that even now are imposed on electronic commerce, is being used as a basis for proposed legislation in Argentina.

2. CNV Resolution 354/2000.
3. Resolution 257/2000 of the Tourism Secretariat.
4. An agency of the Argentine Ministry of Foreign Affairs.
5. Pursuant to NIC-Argentina's internal regulations and Resolution N° 2226/2000 of the Ministry of Foreign Affairs.
6. Due to the large number of domain names registered, and the lack of resources of NIC-Argentina, the renewal process is temporarily suspended.
7. More than 320,000 domain names were registered as of October 2000.
8. After the U.S., the U.K., Germany, the Netherlands and South Korea.
9. The World Intellectual Property Organization has made recommendations to domain name administrators that accurate and reliable contact details of the domain name owners are to be made available and that, if the domain name owner cannot be contacted through the details supplied, the domain name registration should be cancelled.
10. In October 2000, more than thirty-five cases were filed before the Argentine Federal Courts against cybersquatters who deliberately registered a domain name on account of its identity to the trademark of an unconnected well-known organization for commercial gain, based on the Argentine Trademark Law and Section 50 of the TRIPs.
11. A popular ice-cream parlor chain.
12. In September 1999 the Federal Court of Appeals in *Pugliese Francisco v. Perez Carlos* upheld the same legal argument.
13. A few claims by trademark owners against bona fide holders of domain names have been settled. In most of these cases, the defendant registered his or her last name as a domain name, which coincidentally was identical or confusingly similar to plaintiff's trademark or trade name.
14. Consumer rights are protected *inter alia* by the Consumers Protection Act (CPA), Law 22,240; and the Commercial Loyalty Act, Law 22,802.
15. Click-wrap agreements are generally considered "adhesion" contracts, since they do not allow amendments or customization.
16. Argentine Civil Code Section 1154.
17. In the case of an international sale of goods, if the parties have their "places of business" in different contracting countries or the conflict of law rules lead to the application of the law of a particular contracting country, the UN Convention on Contracts for the International Sale of Goods may be applicable. In that case, Section 16(1) of the UN Convention establishes that an offer may be revoked if the revocation reaches the offeree before the acceptance is dispatched.
18. Argentine Civil Code, Sections 1145 and 1146, Sections 917 and 918; Section 18 *et seq.* of the UN Convention.
19. Argentine Civil Code Section 919.
20. Argentine Civil Code Section 1155; Section 22 of the UN Convention.
21. Argentine Civil Code Section 1156.
22. There are some precedents on electronic signature. For instance, Decree 427/98 regulates the use of digital signatures by public administrations.
23. Electronic signatures are relatively easily subject to tampering as compared to their hard copy counterparts. In addition, the lack of face-to-face contact makes it even more difficult to verify the identity of the author of the electronic message. To counter this, many parties conducting business electronically have begun to use cryptographic techniques to digitally "sign" electronic messages. This means that an author can verify his or her identity. In addition, digitally signed messages are tamper-evident.
24. Modeled on the United Nations Commission on International Trade Law Model on Electronic Commerce.
25. This method is the one proposed by the Digital Signatures Act promulgated by the U.S. Congress in June 2000 and accepts more than one method for the recognition of a digital signature's validity.
26. The CPA exempts manufacturers that acquired assets in order to make new products.
27. Argentine Federal Constitution Section 43.
28. As of date of this paper the Executive Power had not yet enacted the Privacy Act, and therefore, if partially or totally vetoed by Executive Power, the provisions may change. The Privacy Act takes into account Directive 95/46 of the European Union, which restricts the international transfer of data to countries that do not have an equivalent level of protection to the country where the data was originated.
29. Argentine courts have indicated that the protection should be extended to electronic mails.
30. The tax rate and taxable base varies depending on the province or provinces where the activities would be deemed to be conducted.
31. Law 24,425.
32. Law 22,362 of 26 December 1980 and its regulation, Decree 558 of 24 March 1981, govern matters related to trademarks and trade names.
33. Const. Art. 107; Law 24,481 of 23 May 1995, t.o. 1996; Decree 260 of 20 March 1996; Law 24,766 of 18 December 1996.

34 Section 6 c).

35. Law No. 11,723 of 28 September 1933 as amended. Argentina subscribed to the Berne Convention of protection of literary and artistic works by Law 17,251 of 25 April 1967.
36. Defined as original works of authorship fixed in any tangible medium of expression, from which they can be perceived, reproduced or otherwise communicated.
37. Paris Convention Section 10 bis 3.1.
38. Law 22,802 Section 9.
39. Criminal Code Section 159.
40. Invisible keywords describing the content of a web site.
41. Criminal Code Section 156.
42. Criminal Code Section 153.
43. Section 50.

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Enforcing Electronic Contracts in the Americas

By Gerald J. Ferguson and Manuel Campos Galvan

I. Introduction

Business is going electronic and business law is being dragged along, whether it is ready or not. In the Americas, both North and South, courts and legislatures are grappling with the new dilemmas that e-commerce can create. These dilemmas are inherently international dilemmas because any company that starts doing business over the Internet immediately has the potential to do international business. The purpose of this paper is to identify the issues that may arise when parties seek to form electronic contracts across national borders, to examine the solutions courts and legislatures have crafted to date and to look at the pending legislation that may ultimately shape the process of contract formation electronically and across borders.

II. The United States Perspective

A. Source of Law

United States lawyers pride themselves on the flexibility of the common law system and the ability of that system to adapt to new legal problems. But electronic contract formation puts that vaunted flexibility to the test. This is so because the dilemmas it creates are so new that there is no guarantee that traditional legal concepts will provide adequate answers. Complicating the situation further is the fact that there is no such thing as "U.S. law" when it comes to contract formation issues—electronic or otherwise. Rather, contract formation is, at the core, a question of state law, meaning that theoretically for every question the possible answer may come in fifty variations. In attempting to make meaningful generalizations about the emerging law of e-commerce, there are three essential sources of law in addition to the limited case law: uniform acts, state legislation and federal legislation.

1. Uniform Acts

Uniform acts are not actual laws but rather are proposed laws endorsed by the National Conference of Commissioners on Uniform State Laws ("Uniform Laws Commissioners") as a model law for state and federal legislators to adopt. The Uniform Laws Commissioners adopted the Uniform Computer Information Transactions Act (UCITA) in July 1999. Their goal in doing so was to provide uniformity in the electronic sale of computer information by electronic means. To that end, UCITA validates the sale or distribution of informational products (*e.g.*, selling computer software via the Internet), provided the user demonstrates an agreement to be bound by the terms and conditions of the transaction. So far, only Maryland and Virginia have passed UCITA into law.

The Uniform Laws Commissioners also attempted to stimulate electronic commerce by setting the framework for general contracting online. Therefore, in July 1999, the Uniform Laws Commissioners approved the Uniform Electronic Transactions Act (UETA). The Uniform Laws Commissioners wanted to place electronic commerce on the same footing as paper transactions, while leaving the substantive law of contracts largely intact. The fundamental premise behind UETA is that the medium in which a record, signature or contract is created, presented or retained does not affect its legal significance. Although uniform laws are not binding on legislators, they are given great weight in promulgating new laws. So far twenty-two states have adopted UETA in some form and six more have introduced legislation to enact UETA.

2. State Legislation

State legislatures addressing e-commerce seek to transplant traditional legal notions into the world of e-commerce. The main objective is to provide transactions occurring via electronic means with the same force and legal effect as paper transactions. This notion, however, has yet to be fully tested, since there is currently a paucity of common law (or case law construing legislation) on the subject. The few decisions that do exist seek to encourage e-commerce by upholding state law principles for e-commerce where possible. These state laws, including the adoption of UETA, are currently still valid to the extent they do not conflict with recent federal legislation dealing with electronic transactions and signatures.

3. Federal Legislation

The federal government has also attempted to reconcile the electronic and the paper realms. Continuing a trend of federal legislation and regulation involving technology issues, which includes the Digital Millennium Copyright Act, the Cyber Squatting Law and the electronic filing of income tax returns, on 16 June 2000 President Clinton signed The Electronic Signatures in Global and National Commerce Act, commonly known as "E-Sign." This law preempts state law, so while states that have adopted UETA without modification will comply with E-Sign, any conflicting modifications will yield to E-Sign. E-Sign is intended to minimize the situations in which federal and state regulators may impose requirements for retention of paper records by

requiring the existence of "a compelling governmental interest relating to law enforcement or national security." The scope of the federal legislation is much broader than the model state law on electronic signatures (known as UETA), in that it addresses transactions associated with an electronic contract, including disclosures and notices to consumers, and, in most cases, supersedes federal and preempts state regulations calling for written documents. In addition, E-Sign contains detailed procedures designed to ensure that a consumer's consent is "informed." For an e-contract to be enforceable, the consumer must also be able to access the electronic information, and electronic records must be retained so they are accessible to the extent required by law.

4. Preemption

Clause 2 of Article 6 of the United States Constitution states that "This Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, anything in the Constitution or Laws of any State to the contrary notwithstanding." This means that in the event of a conflict between state and federal laws, the federal law prevails. The purpose of preemption is to allow Congress to promulgate uniform laws throughout the states regarding various subject matters, including commerce between the states. This doctrine has even extended to areas where Congress has made no law, but a state is intruding upon exclusive federal jurisdiction, as in the "dormant" Commerce Clause cases. The federal jurisdiction for the E-Sign law is in fact based on interstate commerce, and expressly preempts state law in section 102. But E-Sign specifically allows states to adopt UETA, as long as the state does not amend the version proposed by the Uniform Laws Commissioners. The states may also pass laws in this area as long as these laws mention E-Sign, are consistent with E-Sign and do not favor any particular technology regarding electronic contracts or signatures.

B. Various Legal Issues

1. Recognition of Electronic Contracts

Some contracts, in order to be valid, must be in writing. Even where writing is not an absolute requirement, written contracts have been given greater weight by courts and juries. It makes sense that, when the parties have taken the time to sit down and write out their mutual understanding, the document that results is given great weight. But today parties are forming contracts by clicking the "send" button in their e-mail. In light of the fast pace of these electronic transactions, many commentators have worried whether electronic contracts would receive undue scrutiny from the courts. It is safe to say that the overwhelming bias in the emerging e-commerce law is in favor of the enforcement of electronic contracts.

One of the first important developments in favor of the recognition of electronic contracts was the Uniform Laws Commissioners' approval of UETA in July of 1999. The purpose of UETA is to "facilitate electronic transactions consistent with other applicable law."[1] UETA requires that an electronic "record" (which, according to UETA § 2(7), is a document "created, generated, sent, communicated, received, or stored by electronic means") be given the same legal effect and enforceability as a regular written document. Thus, if a law requires a contract to be in writing, an electronic record will satisfy this requirement. In short, most electronic contracts will enjoy the same status as a regular written contract when faced with a requirement to be in writing. Although generally broad in application, UETA does contain important exceptions. It does not apply to wills and certain transactions under the Uniform Commercial Code.

Before Congress passed E-Sign, some states acted and adopted legislation which gives electronic contracts the same status as written agreements. In September of 1999, New York enacted a statute echoing UETA that provides that electronic records are to be given the same force and effect as those records not produced electronically. Significantly, the New York statute carves out not only wills but also real property contracts.[2] Also in September of 1999, California's Governor approved a bill enacting UETA's approach to electronic records.[3] In mid-December, the Governor of Pennsylvania signed a bill which is consistent with UETA's approach.[4] And Illinois adopted a slight variation on the same theme with Public Act 90-0759 § 5-115 which states that, "Where a rule of law requires information to be 'written' or 'in writing,' or provides for certain consequences if it is not, an electronic record satisfies that rule of law."[5] Other states are also addressing this issue and following UETA regarding the validity of an electronic record. Last spring, the New Jersey Assembly debated an act that would allow an electronic record to satisfy the Statute of Frauds writing requirement.[6] This proposed piece of legislation will probably be addressed in New Jersey's next legislative session. The Information Technology Division of the Commonwealth of Massachusetts drafted a Uniform Electronic Transaction Act in October of 1999[7] that adopts UETA's approach to electronic records. As discussed, any variation from the UETA standards may be subject to preemption by E-Sign.

While electronic transactions are relatively new, legislatures are recognizing that these transactions are an important part of American commerce, and their importance will only increase in the future. As a result, states

are looking for ways to promote such commerce. In navigating this uncharted territory, UETA is providing guidance to the state legislatures. Therefore, a contract that must be in writing in order to be valid can either be a "hard" document or an electronic one. States remain reluctant to permit electronic records in certain circumstances—such as wills or real property transfers—where it is essential to have accurate records that are difficult to falsify. But the problems of accuracy and falsifiability are technical problems, not legal problems. As technical solutions to these problems emerge, the challenge for lawmakers will be to adopt flexible legislation that frees business parties to take advantage of such solutions.

2. Electronic and Digital Signatures

In an attempt to promote e-commerce, states are also taking steps to give computerized signatures the same force and effect as regular penned signatures. Although UETA also addresses electronic signatures, many states enacted electronic signature legislation prior to the adoption of UETA, and there is greater variety among the states as to how such signatures are treated. It remains to be seen whether and which of these state laws will be abrogated as inconsistent with the federal E-Sign law. Accordingly, businesses engaged in electronic commerce must be aware of these differences as commerce moves invisibly across state lines.

The problem begins with the fact that what is meant by a computerized signature can vary significantly. Under UETA, any sound, symbol or process associated with an individual seeking to sign an electronic communication is a valid signature. E-Sign is silent on when an electronic signature may be attributed to a particular person, so if adopted by a state, UETA would govern. Under UETA, the notation "/s/ John Hancock" would be a valid signature. Some states, however, have taken a more conservative approach and require what is known as a "digital signature," which is a type of electronic signature. A digital signature is "created and verified by cryptography, the branch of applied mathematics that concerns itself with transforming messages into seemingly unintelligible form and back again."[8] The secret coding is usually registered with a state's electronic administrator. The advantage of a digital signature is that its validity is independently verifiable both by the parties to the agreement and by a fact finder seeking to resolve any subsequent dispute.

Further complicating the situation, Illinois has enacted legislation which allows for electronic signatures, secure electronic signatures and digital signatures. A "secure electronic signature" is similar to a "digital signature" in that it can be verified by the parties to a transaction, but is different in that there is no third party also acting as an independent source of verification. While all of these forms of computerized signatures are accepted as a signature, each is given a differing legal status. An electronic signature will satisfy a signing requirement, but a secure electronic signature will form a "rebuttable presumption that it is the signature of the person to whom it correlates."[9] As a result, the party challenging the integrity of the electronic secure signature will bear the burden of rebutting the presumption that the signature was genuine. The use of state-certified digital signatures is considered to be conclusive proof that a document was signed by the individual purporting to sign it, so long as proper certification procedures are followed.

It is evident from the foregoing that the states are not taking a uniform approach to electronic signatures, although it remains possible that the states will start to coalesce around the flexible approach to electronic signatures proposed in UETA. To the extent that the goal is to promote e-commerce, states would do well to follow UETA's model, which gives the contracting parties the freedom to define for themselves, through their own agreements and practices, what they will accept as electronically signed documents. To the extent that legislatures impose their own judgments as to what constitutes a sufficiently "secure" signature to warrant recognition in the courts, these legislatures may be interfering with the ability of each industry to develop standard electronic signature practices which are best suited to the needs of each industry. They may also run afoul of the E-Sign legislation, while the model version of UETA will not.

3. Click-Through Agreements

Promoting widespread recognition of electronic contracts should prove to be the easy part of developing a legal framework for electronic commerce. The more interesting question may prove to be this: what conduct constitutes sufficient conduct to form an electronic contract? In the formation of all contracts, including those created via the Internet, mutual assent by both parties is required. Traditionally, such assent was manifested by signing and exchanging documents, but in today's world of electronic commerce, the rules are changing. Current Internet technology allows parties to agree to contract simply by clicking through webpages listing the terms of the contract before consummating the transaction. Such agreements are commonly known as "click-wrap" or "click-through" agreements. (The name "click-wrap" derives from the early software agreements that came bound inside the box containing the computer software. These boxed software agreements are often referred to as "shrinkwrap agreements.")

Though "click-wrap" agreements are practical in that they facilitate speedy online commerce, some commentators have questioned their enforceability from a legal standpoint. These commentators claim that contracts arising from a "click-through" should be unenforceable because they may deny parties (particularly small businesses and consumers) an opportunity to evaluate the terms of the agreement and consider its consequences.[10]

Despite these criticisms of "click-wrap" agreements, the early indications from the courts are that such agreements will be upheld as enforceable. For example, in *Hotmail Corp. v. Van$ Money Pie, Inc.*, the court held that a mass-marketing "click-wrap" agreement was binding on a party, and that a party who violated the terms could be held in breach of contract.[11] A New Jersey court also addressed the validity of "click-wrap" agreements in *Caspi v. Microsoft Network*, and held that an electronic contract agreed to by a "click" of a mouse was just as binding as a written contract.[12] This result is consistent with the approach that courts have taken toward "shrinkwrap agreements": Courts have generally held these agreements to be binding.[13]

Uniform acts, such as UETA and UCITA, are also promoting the acceptance of "click-wrap" agreements. Under § 5(b) of UETA, a court should look at the "context and surrounding circumstances, including the parties' 'conduct' to determine if the buyer and seller agreed to conduct transactions."[14] Furthermore, under § 14, an individual may consummate an automated transaction if "the individual knows or has reason to know [that his action(s)] will cause the electronic agent to complete the transaction or performance."[15] From these two sections it follows that, if the parties knew that their "clicking" of an acceptance clause would complete a transaction, a court should hold that such conduct constitutes assent to the transaction. States have already begun adopting legislation based on this uniform model. In September of 1999, California adopted a bill enacting UETA § 5(b) and § 14.[16] Pennsylvania adopted the same language on 16 December 1999.[17] In Massachusetts, a draft proposal based on UETA has been circulating but not yet addressed by that state's legislature.[18]

UCITA specifically addresses the sale and distribution of "data, text, images, sounds, mask works, or computer programs, including collections or compilations of them,"[19] activities which include the sales of computer software or information over the Internet. UCITA is intended to validate broadly such transfers over the Internet by promoting a flexible approach to determine whether a user has demonstrated his or her consent to be bound by the terms and conditions in a "click-wrap" agreement. Under UCITA, a person can manifest assent to a record or term if the person, after having an opportunity to review the record, authenticates the record or engages in other affirmative conduct indicating acceptance.[20] Though "affirmative conduct" has yet to be judicially defined, it seems likely that clicking "yes" on a message box after having an opportunity to view the agreement would constitute such affirmative conduct. The answer will ultimately lie in the form in which legislatures adopt UCITA or any related legislation. As of yet, only Maryland and Virginia have adopted UCITA.

Due to the high volume of electronic transfers via the Internet, the validity of "click-wrap" agreements is of prime importance for those involved in sales through the Internet. Although little guiding case law and legislation exists, current trends indicate that legislatures and courts will be willing to permit the enforcement of such agreements.

4. Enforcing Web Site Terms of Use

In an attempt to limit their liability or impose rules governing the use of their Web sites, site hosts are employing "terms of use" statements. Such terms are usually found by accessing a link located at the bottom of the webpage. Web site owners do not want to use "click-through" agreements before giving access to their Web sites because web surfers are notoriously impatient and may refuse to use a site that requires them to click-through a message box every time they want to access it. Although providing access to the terms of use through a link at the bottom of the home page is more user-friendly than the potentially burdensome "click-through" agreements, more serious questions arise with respect to their enforceability.

In a positive development for Web site operators not using "click through" agreements, in December of 2000 Judge Barbara S. Jones of the Southern District of New York issued a preliminary injunction preventing Web hosting company Verio Inc. from extracting and profiting from the customer database of Register.com in violation of the terms of use found on Register.com's Web site. Verio was using an automated software program to retrieve newly registered domain names from Register.com's database for use in Verio's direct marketing campaign. Verio disputed Register.com's claims by arguing, among other things, that Register.com's terms of use are unduly restrictive. Judge Jones rejected Verio's arguments, holding that Register.com's terms of use are enforceable. The judge held that, regardless of the restrictiveness of Register.com's terms of use, Verio was bound by its provisions by virtue of its accessing Register.com's database.[21]

As mentioned above, UCITA covers computer information transactions, which includes providing

information over the Internet. At § 209, UCITA validates mass-market licenses for informational products, provided the user demonstrates his or her agreement to be bound by the terms and conditions. A person can manifest assent to a record or term if the person, after having an opportunity to review the record, authenticates the record or engages in other affirmative conduct indicating acceptance. UCITA's § 209 clearly provides that an integral part of manifesting assent is the user's knowledge of or opportunity to understand the terms to which the user is agreeing. The key question is how the Web site owner gives this user the opportunity to understand what he or she is agreeing to. According to UCITA, the Web site owner can provide users with the opportunity to learn of the terms and conditions for use by

> displaying prominently and in close proximity to a description of the computer information, or to instructions or steps for acquiring it, the standard terms or a reference to an electronic location from which they can be readily obtained; or disclosing the availability of the standard terms in a prominent place on the site from which the computer information is offered and furnishing a copy of the standard terms on request before the transfer of the computer information. . . .[22]

This provision suggests that Web site terms of use will be enforced so long as the Web site owner displays the link to the terms of use prominently on the home page of the Web site.

But, as mentioned above, UCITA has only been adopted in two states. In practice, if a Web site host wants to take every step to promote the enforceability of its terms of use, the Web site owner should employ "click-through" type agreements that require the user to agree to the terms before getting access to the site. Such agreements may be appropriate for sites that may have greater than normal liability concerns, such as sites that provide medical information.

Even if UCITA is generally adopted, all provisions in the terms of use may not be enforced. Specific provisions may be void under state law or under regulations pertaining to specific industries. Nonetheless, the early case law, and the software industry's experience with shrinkwrap agreements, suggests that many of these provisions will be enforced.

(a) Liability Disclaimers

Many Web site terms of use contain a limitation of liability clause, including the typical bold-faced disclaimers about goods, services or information being provided "as is" with no representations or warranties, and disclaimers of any implied warranties. Under UCITA, the liability of the Web site owner can be limited—provided that the user agrees to such limitations. UCITA's § 807(b) provides that "[a] party [to an Internet transaction] may not recover consequential damages for losses resulting from the content of published informational content unless the agreement expressly so provides." Consequential damages include "lost profits resulting from that lost opportunity, damages to reputation, lost royalties expected from a licensee's proper performance, lost value of a trade secret from wrongful disclosure or use, wrongful gains for the other party from misuse of confidential information, loss of privacy, and loss or damage to data or property caused by a breach."[23]

Although no courts have specifically addressed the issue of a Web site disclaiming consequential damages, courts have allowed such disclaimers in the context of "shrinkwrap" agreements. In *M.A. Mortenson Co., Inc. v. Timberline Software Corp*, the buyer of computer software used by contractors in preparing construction bids brought an action against the software sellers, alleging that the software caused the buyer to submit an inaccurate bid and was damaged as a result.[24] Timberline Software shipped the diskettes in sealed envelopes that were placed inside white product boxes. The full text of the license agreement was printed on the outside of each sealed envelope. The license agreement was also printed on the inside cover of the user manuals and a reference to the license agreement appeared on the introductory screen each time the program was executed. The licensing agreement contained a limitation of liability clause, including a disclaimer of any liability for lost profits. The court found the license terms to be an enforceable part of the contract, provided it was not unconscionable. "Whether a limitation on consequential damages is unconscionable is a question of law. The burden of establishing unconscionability is on the party challenging the limitation."[25] In this case, the plaintiffs did not meet this burden, so the defendants were granted summary judgment.

(b) Indemnity

Many Web site terms of use also require the user to indemnify the Web site owner, provided that the user agreement specifically says so. Although the enforcement of such indemnities will ultimately turn on state law, UCITA promotes the enforcement of such indemnities so long as the indemnity provision is expressly, conspicuously and clearly placed in the terms of use.[26] The method of consent to the terms of use—or displayed link—will likely be significant under the law of the state where the indemnity is sought to be enforced.[27]

(c) Jurisdiction, Choice of Law and Choice of Forum

Again, the legal authorities available to date suggest a trend in favor of enforcing choice of law and choice of forum clauses, although the particular law of each state will be significant in this analysis. Although New York courts have not specifically ruled on Internet forum selection clauses, such clauses are generally enforceable in New York State, absent a showing that enforcement would be unreasonable and unjust or that the clause is invalid because of fraud or overreaching.[28] Therefore, it is likely (based on authority from other jurisdictions) that New York courts would enforce a "click-wrap agreement" that required a Web site user to submit to the jurisdiction of a particular court. UCITA's § 110 allows the parties to select the forum and law to be applied: "The parties in their agreement may choose an exclusive judicial forum unless the choice is unreasonable and unjust." Additionally, § 109 of this model act provides that, "The parties in their agreement may choose the applicable law. However, the choice is not enforceable in a consumer contract to the extent it would vary a rule that may not be varied by agreement under the law of the jurisdiction whose law would apply. . . ."

Courts that have enforced forum selection clauses tend to evaluate the following factors: the intent of the parties; the manifestation of the parties' assent; and the reasonableness of the forum selection clause. The case of *Groff v. America Online Inc.* provides an example where a court held that a mass-market forum selection clause was enforceable.[29] The case involved America Online (AOL) customers who sued AOL, alleging that at the time they accepted AOL's offer for unlimited service, AOL knew it would be unable to provide that service. When the plaintiffs signed up for AOL they were required to click through a "click-wrap" agreement. The "click-wrap" agreement contained a forum selection clause expressly providing Virginia law and the Virginia courts as the appropriate legal forum for the litigation. The court held that by clicking through, the plaintiff accepted AOL's terms because although the "plaintiff had the option not to accept defendant's terms, [he] did not. He chose to go on line."[30] This court also stated that "[g]enerally, a plaintiff's choice of forum is entitled to great weight and should be disturbed only in exceptional circumstances."[31] Nonetheless, the burden of persuading the court of the clause's unreasonableness was on the plaintiff, and he did not meet that burden. Thus, AOL's motion to dismiss based upon improper venue was granted.

In cases where courts have considered whether they should exercise jurisdiction over a company based on the company's Web site activity in the forum, courts have considered and given effect to forum selection clauses in Web site terms of use. In *Decker v. Circus Circus Hotel*, the plaintiffs commenced a personal injury action in a New Jersey court against Circus Circus Hotel ("Circus Circus"), a Nevada corporation with its only place of business in Las Vegas, Nevada.[32] In attempting to gain personal jurisdiction over Circus Circus, the plaintiffs argued, among other things, that Circus Circus maintained a Web site for customers to transact business nationwide. The court held that, although maintaining a Web site does open the defendant to jurisdiction, the "defendant's Internet site contains a forum selection clause requiring that, by making a reservation over the Internet, customers agree to have their disputes settled in Nevada state and federal courts. This forum selection clause ought to be enforced."[33] Therefore, the action was transferred to the District Court of Nevada.

While no courts have addressed the required level of prominence of a "Terms of Use" statement, disputes arising over this issue are sure to arise in the future. In the meantime, it is advisable that a host exhibit the terms of use in an obvious location on the home page. Regarding disclaimers, courts have already enforced such clauses in some circumstances and UCITA promotes the enforcement of such clauses. Therefore, it is a prudent practice to include a terms of use section in any Web site, and to make the link to the terms of use as prominent as possible without interfering with the functional purposes of the site.

III. The Latin American Perspective

A. Legal Issues Pertaining to E-Commerce in Latin America

Latin America has one of the world's fastest growing rates of Internet connectivity. Several factors have contributed to the increasing use of e-commerce in Latin America. These include the widespread access to computers by comparatively large segments of Latin America's middle and professional classes (which have been fueled lately by accessible options both to Internet service and computers, like the recent offer of low-cost computers by Mexico's Telmex to users of its Internet service) and the continuing exposure through the media, especially television, to the varieties of e-commerce. Free trade treaties have also played an important role in Latin America's embrace of e-commerce by allowing penetration by distributors and firms engaging in e-commerce activities in the United States. The combination of these factors will cause e-commerce to grow rapidly in a region whose international trade itself has grown exponentially in the last decade, particularly since the advent of NAFTA and MERCOSUR.

There is a concern, however, that current laws in Latin America governing commercial transactions are not well suited to regulate electronic transactions, and thus may hinder the development of e-commerce. Specifically, Latin American transactional laws are still heavily influenced by nineteenth century civil codes, which require certain formalities in the formation of contracts. The prevailing principles in Latin American legal systems have a close relation to the paper/handwritten signature environment. They do not recognize electronic messages in such systems generally, and it is therefore not surprising that considerable uncertainty exists with respect to the enforceability of electronic contracts and undertakings. This uncertainty applies to issues as basic as whether an electronic contract is enforceable, especially when the value thereof exceeds that mentioned in the statute of frauds provision of civil or commercial codes. And though many commercial codes regulate activities with or between merchants, it is not clear if these commercial codes would enforce a contract lacking the traditional writing or signature requirements. It is also unclear what would be the evidentiary value of electronic messages and the validity of electronic documents.

Several Latin American countries such as Argentina, Brazil, Chile, Colombia, Ecuador and Peru have either proposed or enacted regulations, or tried to adapt or expand traditional legal notions, to include the electronic equivalents. Since the discussion of all the currently proposed and enacted e-commerce legislation in Latin America is beyond the scope of this article, we have taken the example of Mexico's newly enacted amendments to several key laws as an example of the manner in which existing legal obstacles to the development of e-commerce in Latin America have been resolved in these jurisdictions.

B. The Mexico Perspective

In April 2000, Congress approved amendments to the Civil Code for the Federal District, the Federal Procedure Code, Commerce Code and the Consumer Protection Law, in order to modify Mexico's legal infrastructure to allow the operations of electronic businesses.

These amendments, which became effective on 7 June 2000, are based on the model law for electronic business prepared by UNCITRAL, which intends to provide a framework that will facilitate the development of electronic commerce.

Prior to the introduction of these amendments, Mexican law did not make any reference whatsoever to electronic transactions, and therefore created a vacuum on the interpretation and treatment that courts would give to electronic commercial transactions in general. The new amendments provide security to the parties involved in electronic transactions by recognizing, among other things, that offer and acceptance can be made through electronic means as long as such electronic information can be attributed to the originators and is accessible in the future.

These amendments do not include a concept for "digital signatures" as established in the UNCITRAL model law, but allow the establishment of the origin of an offer or acceptance based on the degree of certainty that such information can be attributed to the originator. This part of the amendments can be interpreted as the basis upon which different technologies, such as digital signatures, can be used to guarantee the origin of the offer and acceptance.

The amendments to the Federal Code of Civil Procedure consist of the addition of an article that recognizes as evidence the information or exchange of information that is contained in magnetic, optical or any other media. However, judges will have the discretion to weigh the evidence, based on the reliability of the technology that generated, received, transmitted or archived the information. Likewise, this amendment allows for the presentation of information in electronic form when the law calls for an original document, as long as it can be evidenced that such information has not been altered since its creation or generation and is available for subsequent retrieval.

The Commerce Code has also been subject to several amendments that include the modernization of the Public Registry of Commerce, the digitalization of the information contained in the Registry, as well as the use of electronic signatures by Public Registry Officials with respect to information related to the Public Registry of Commerce. However, these amendments are not limited to the public records, since they recognize the execution of mercantile agreements through the use of electronic media. The amendments also allow for the use of data messages in lieu of paper documents when the law requires the formality to be set in writing, as long as they can be attributed to the obligated parties and are accessible in the future. Data messages can also be admitted in commercial trials as evidence and their strength will be determined by the reliability of the method or technology used to generate, archive or transmit the message.

The Consumer Protection Law was also amended in order to protect the rights of consumers when they engage in electronic business transactions. These rights are varied, and among the most important ones is the prohibition against using or revealing information obtained during the course of an electronic transaction without the prior consent of the consumer. The amendments also impose on the provider of goods or services

the obligation to use the available technology to guarantee the security and privacy of the exchange of information during such transactions, as well as to provide a physical address and other general information of the provider of goods and services to the consumer.

Endnotes

1. UETA § 6(1).
2. *See* N.Y.S. A02566, 2566—B, § 5-1709(3) (1999).
3. *See* Cal. Civ. Code Title 2.5 § 1633.7.
4. *See* 73 P.S. § 2260.303.
5. *See* Ill. Comp. Stat. 175 1-101 (1999).
6. *See* N.J. No. 3039, 208th Legis. (1999).
7. *See* Commonwealth of Massachusetts Uniform Electronic Transactions Act Draft (26 October 1999). (A copy of this draft can be found at <http://www.magnet.state.ma.us/itd/legal/uetamass.htm>).
8. *See* Conn. Sub. Bill No. 6592 (1999).
9. A.B.A. Section of Science and Technology Information Security Committee, Digital Signature Guidelines Tutorial. *See* <http://www.abanet.org/scitech/ec/isc/dsg-tutorial.html>.
10. *See* Founds, *Shrinkwrap And Clickwrap Agreements: 2B Or Not 2B?*, 52 Fed. Comm. L.J. 99, 101 (1999).
11. *Hotmail Corp. v. Van$ Money Pie, Inc*, 1998 WL 388389 (N.D. Cal.).
12. *Caspi v. Microsoft Network, LLC*, 323 N.J. Super 118 (1999).
13. *See, e.g.*, *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996).
14. UETA § 5(b).
15. UETA § 14(2).
16. *See* Cal. Civ. Code Title 2.5 § 1633.1.
17. *See* PA. Senate Bill No. 555, Printer's No. 1555, § 301(b), § 307(g)(2) (1999 Session).
18. *See* note 7 *supra*.
19. UCITA § 102(35).
20. UCITA § 112.
21. This decision is available at <http://www.icann.org/registrars/register.com-verio/order-08dec00.htm>.
22. UCITA § 211.
23. UCITA § 102(13).
24. *See M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 970 P.2d 803 (Wash. App. 1999).
25. *Id*. at 811.
26. UCITA § 102, reporter's notes (comments on previous draft on parallel provision).
27. *See, e.g., THC Holdings Corp. v. Tishman*, 1998 WL 305639 (S.D.N.Y.) ("The right to indemnification . . . may be based upon an express contract or an implied obligation.") (citations omitted); *Teal v. Pittson Co., Inc.*, 1993 WL 85989 (E.D.Pa.) (noting that, under California law, "when parties expressly contract regarding a right to indemnification, the extent of that right is determined solely from the pertinent contract language.").
28. *Personius v. Butters*, 249 A.D.2d 831 (3d Dep't 1998); *National Union Fire Ins. Co. v. Williams*, 223 A.D.2d 395 (1st Dep't 1996) ("It is the policy of the courts of [New York] State to enforce contractual provisions for choice of law and selection of a forum for litigation. It is settled that a selection of forum clause affords a sound basis for the exercise of personal jurisdiction over a foreign defendant. Forum selection clauses should be enforced absent a showing that they result from fraud or overreaching, that they are unreasonable or unfair, or that their enforcement would contravene some strong public policy of the forum.").
29. *Groff v. America Online Inc.*, 1998 WL 307001 (R.I. Super.).
30. *Id*. at *6.
31. *Id*.
32. *See Decker v. Circus Circus Hotel*, 49 F. Supp. 2d 743 (D.N.J. 1999).
33. *Id*. at 748.

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The North American Free Trade Agreement: The Provisions for the Temporary Entry of Canadian and Mexican Business Persons Into the United States

By Kenneth A. Schultz

I. Introduction

The North American Free Trade Agreement (NAFTA) entered into force on 1 January 1994, committing the United States, Canada and Mexico to the reduction of existing barriers to trade and the freer movement of capital and labor. NAFTA was modeled on the United States-Canada Free Trade Agreement (CFTA) which had become effective 1 January 1989 and included reciprocal provisions for facilitating temporary business travel of citizens of the two countries in a Chapter 15 entitled "Temporary Entry for Business Persons." The immigration provisions of NAFTA, similar to those of CFTA, appear at Chapter 16 and bear the same title as CFTA's Chapter 15. With the implementation of NAFTA, the immigration provisions of CFTA were suspended.

Chapter 16 of NAFTA provides for a number of substantive and/or procedural variations in connection with three long-standing U.S. nonimmigrant visa statuses important to the international business community. It also includes a status which first appeared in CFTA. The visa statuses involved are "Business Visitors," "Traders and Investors," "Intracompany Transferees," and "Professionals." For these, NAFTA liberalizes the practices that would otherwise apply to the temporary entry of Canadian citizens and, to a lesser extent, Mexican citizens. NAFTA, however, makes no provision for permanent immigration. Rather, it is designed to facilitate the *temporary* travel of a business person, defined as a "citizen of a Party who is engaged in the trade of goods, the provision of services or the conduct of investment activities." The term "temporary entry" is defined as an entry "without the intent to establish permanent residence." Interim rules implementing the immigration provisions of NAFTA were published by the Immigration and Naturalization Service two days before NAFTA's effective date,[1] and final rules were promulgated four years later.[2]

This article will highlight NAFTA's provisions for business visitors (B-1), traders (E-1) and investors (E-2), intracompany transferees (L-1), and professionals (TN).

II. Business Visitors

NAFTA has not substantially altered existing practice with respect to Canadian or Mexican business visitors seeking entry to the United States pursuant to the Immigrant and Nationality Act ("INA" or "Act") § 101(a)(15)(B)[3] or the practices for Canadians who entered pursuant to CFTA prior to 1 January 1994.

Appendix 1603.A.1 to Annex 1603 of NAFTA provides a list of the authorized "business visitor" activities. This appendix is almost identical to the list of business activities authorized by Schedule 1 to Annex 1502.1 of CFTA. In furtherance of NAFTA's objective of establishing transparent criteria for temporary entry, specific occupations are listed by category under the following headings: research and design; growth, manufacture and production; marketing; sales; distribution; after-sales service; and general service. This list is not exhaustive because Canadians and Mexicans also have the option of seeking B-1 entry under the general provisions of the Act.

Procedurally, NAFTA does not provide any additional benefits to Canadian or Mexican business visitors. Canadians do not need B-1 (business visitor) visas to apply for entry and the existing requirement for Mexicans to have a visa or possess a border crossing card is not modified.

III. Treaty Traders and Investors

Perhaps the most significant immigration contribution of NAFTA was the granting of the right to Mexicans to enter the United States as treaty traders (E-1) or treaty investors (E-2) pursuant to the INA § 101(a)(15)(E).[4] Canadians had earlier acquired these benefits under CFTA and NAFTA continued them. The E status is a benefit accorded to qualified nationals of countries who ordinarily enter the United States under provisions of a treaty of friendship, commerce and navigation or a bilateral investment treaty. NAFTA, by executive agreement, provides the same benefits to qualified Canadians and Mexicans to engage in substantial trade between the United States and the country of the alien's nationality or to invest a substantial amount of capital in an enterprise in the United States.

The lone distinction under the treaty trader and investor provisions of the Act and NAFTA is that a Canadian or Mexican may be denied E classification if the Secretary of Labor advises the INS Commissioner that a strike or other labor dispute involving a work

stoppage of workers in the alien's occupational classification is in progress where the alien will be employed; *and* the alien's entry may adversely affect the settlement of the labor dispute or the employment of any person involved in the dispute. If the Canadian or Mexican has already commenced employment in the United States, he or she may continue to work or participate in the strike or work stoppage and be considered to be properly maintaining E status assuming all other conditions of the entry are adhered to.

Notwithstanding that Canadians are ordinarily exempt from the need to present nonimmigrant visas, NAFTA, like CFTA, requires that Canadian treaty traders and investors be in possession of an E-1 or E-2 visa issued by an American consular officer. Mexicans are similarly required to have the applicable visa.

IV. Intracompany Transferees

The substantive provisions of NAFTA for entry by Canadian and Mexican L-1s (intracompany transferees) are identical to existing requirements in the INA § 101(a)(15)(L)[5] and 8 C.F.R. § 214.2(l) except for the addition of provisions concerning labor disputes. An L-1 petition on behalf of a Canadian or Mexican may be denied (or the alien denied entry after approval of the petition) if the Secretary of Labor has advised the INS Commissioner of any labor dispute involving a work stoppage and the alien's entry may adversely affect the dispute. Like the E provisions, if the alien has already begun employment in the United States, the alien may continue working in status or even strike without being deemed to have violated his or her status assuming all other conditions of the entry are maintained.

Procedurally, NAFTA modifies the rules for filing L-1 petitions on behalf of Canadians and leaves in place existing rules for Mexican nationals who continue to be treated like nationals of all other countries. NAFTA allows Canadians to file L-1 petitions at a Class A port of entry located along the U.S.-Canadian border or at a pre-flight/pre-clearance station located in Canada. The opportunity to do filings at the border, or at pre-flight inspection, allows Canadians to have their L-1 petitions approved right away, instead of waiting for normal processing by a Regional Service Center. Canadians, however, may also file conventionally with the appropriate Regional Service Center.

A Canadian (or a Canadian resident, *i.e.*, landed immigrant, of a common nationality with a Canadian) spouse and unmarried minor children who accompanies or follows to join the principal (L-1) alien is admitted under the classification symbol L-2 for the same period of time. However, non-Canadian spouses and unmarried minor children may only "follow to join," since they are not visa exempt and, therefore, are not able to obtain L-2 visas until the principal alien has been admitted to the United States in L-1 status.

Mexicans, unlike Canadians, may only have their L-1 petitions filed with the Regional Service Center having jurisdiction for the place of employment. Mexicans also require L-1 visas and do not appear to obtain any benefits from NAFTA beyond those available under the Act. In fact, NAFTA compromised the L-1 provisions of the Act for Mexicans, as well as Canadians, by introducing the "labor dispute" provisions barring L-1 entries.

V. Professionals (TN) and Their Dependents (TD)

NAFTA also provides for the temporary entry of Canadian and Mexican business persons "to engage in activities at a professional level." This phrase is defined to mean undertakings requiring the individual to have at least a baccalaureate degree or appropriate credentials demonstrating professional status. A significant change from the text of the earlier CFTA provision is that the NAFTA definition specifically precludes the establishment of a business in the United States in which the professional will be self-employed. The TN classification is also subject to "labor dispute" provisions identical to those applicable to L-1 status.

H-1B status, which also provides for the entry of professionals, should not be confused with TN under NAFTA. The preamble to the INS interim rule specifically stated that admission pursuant to NAFTA to engage in professional level activities does not imply qualification as a "professional" under INA § 101(a)(15)(H)(i),[6] or § 203(a)(3).[7] The H-1B category is for "specialty occupations," namely, those in occupations for which an entry level requirement is customarily a university degree at the American baccalaureate level. While the designation of some professional ("specialty") occupations for H-1B purposes and the criteria for membership continue to be problematic, NAFTA seeks to simplify the admission process for a select and precisely defined group of Canadian and Mexican professionals.

Appendix 1603.D.1 to Annex 1603 of the NAFTA lists those occupations deemed professional for purposes of TN classification. Each occupation listed on Appendix 1603.D.1 requires a baccalaureate or *Licenciatura* degree unless specified otherwise. Some occupations require a degree *or* either a provincial or state license (*e.g.*, architect, engineer, forester, land surveyor, lawyer, dietician, occupational therapist, physiotherapist, psychologist, and registered nurse). Other occupations require a degree *or* post-secondary diploma or certificate and three years' experience (*e.g.*, computer systems analyst, graphic designer, hotel manager, industrial designer, interior designer, technical publica-

tions writer, and medical laboratory technologist). And a small number of occupations have unique requirements, including disaster relief insurance claims adjuster, librarian, management consultant, and scientific technician/technologist.

A. Admission Procedures for Canadians

The admission procedures for Canadian and Mexican TNs are decidedly different from each other. As with the CFTA, a Canadian may simply apply for admission to the United States to engage in a listed activity at a Class A port of entry, a United States international airport, or a United States pre-clearance/preflight station. No petition, visa or other form is needed. The Canadian must simply document that he or she is seeking temporary entry to engage in a listed profession or occupation. The documentation takes the form of a letter from the prospective U.S. employer, supported by licenses, diplomas, degrees, certificates, or membership in professional organizations. Regulations provide that the documentation must be sufficient to establish the activity to be engaged in; the purpose of entry; the anticipated length of stay; the educational or other credentials demonstrating professional level status; compliance with applicable state laws and/or licensing requirements, if any; and the arrangements for remuneration for services to be rendered.

A qualified Canadian will be admitted for up to one year and given a form I-94 with the classification symbol TN and a receipt, upon payment of the required $50 fee. Provided the business activity and employer have not changed, the Canadian may reenter the United States on an unexpired form I-94 without any other employment-related documentation or an additional fee. If the Canadian no longer has the original I-94, he or she may present alternative evidence such as the original INS TN fee receipt or a TN admission stamp in a passport and a confirming letter from the U.S. employer.

A Canadian (or a Canadian resident, *i.e.*, landed immigrant, of a "common nationality" with a Canadian, *i.e.*, a citizen of a British Commonwealth country or Ireland) spouse or unmarried minor child may accompany or follow to join the principal TN alien in TD status without a fee or a nonimmigrant visa. Dependents of other nationalities must obtain a TD nonimmigrant visa following the principal alien's admission in TN classification. In either instance, admission in TD status shall be for up to one year. Neither a dependent spouse nor a minor child may accept employment.

A Canadian citizen admitted in TN status may apply for extension(s) of stay in increments of up to one year without regard to the time limitations imposed on the L-1 and H-1B classifications. An extension application must be accompanied by letter(s) from the U.S. employer(s) confirming the continuing need for the Canadian's services for a specified period of time. Regulations also provide the same procedure for changing or adding U.S. employers.

The TD spouse or child of a Canadian TN may also be granted extensions of temporary stay in increments of up to one year, provided the principal alien is maintaining status.

B. Admission Procedures for Mexicans

However, no streamlined admission process exists for Mexican TNs. The provisions for a Mexican who applies for admission to the United States to engage in a listed activity on Appendix 1603.D.1 are the same as the H-1B (specialty occupation) procedures, except that the form 1-129 petition must be filed with the Nebraska Service Center regardless of the place of employment. Before the petition is filed, the prospective U.S. employer must comply with the H-1B "labor condition application" requirements. Mexicans will also need TN or TD visas and will be subject to the same time limitations as discussed above in regard to Canadians. The procedures for extension(s) of status for Mexicans will be the same as for Canadians as well, except that the petitions must be filed with the Nebraska Service Center. Finally, not more than 5,500 Mexicans may be classified TN annually (exclusive of petition extensions or extensions of stay): the number does not include spouses and children. The number can also be increased by mutual agreement of the United States and Mexico and the numerical limitation will sunset on 31 December 2003.

VI. NAFTA Working Group and Dispute Resolution

The purpose of NAFTA Chapter 16 is to facilitate temporary entry of business persons on a *reciprocal* basis while ensuring border security, and protecting indigenous labor and permanent employment. NAFTA contemplates that the process will be an evolving one and recognizes that, inevitably, disputes will materialize. NAFTA, therefore, provides that representatives of each party will form a Working Group to consult at least once a year regarding the implementation of Chapter 16 and "the development of measures to further facilitate temporary entry of business persons on a reciprocal basis; the waiving of labor certification tests or procedures of similar effect for spouses of business persons who have been granted temporary entry for more than one year under Sections B (traders and investors), C (intracompany transferees) or D (professionals) of Annex 1603; and proposed modifications of or additions to this Chapter (16)."

NAFTA also provides that any party may invoke dispute resolution procedures regarding Chapter 16, but not with respect to the denial of a business person's

request for temporary entry unless it involves a pattern or practice *and* all administrative remedies have been exhausted. If a final decision has not been issued within one year after the commencement of administrative proceedings (through no fault of the business person), the latter requirement will be deemed to have been met. Since neither NAFTA nor the implementing regulations include provisions for administrative review of individual cases, other than L-1 or TN petitions on behalf of Mexicans, it appears that business visitors and Canadian professionals will have to pursue and exhaust their administrative remedies through removal proceedings before an Immigration Judge (with appeal to the Board of Immigration Appeals) before dispute resolution procedures could be invoked. Canadian intracompany transferees can opt for the filing of an I-129L petition with the appropriate Regional Service Center if denied entry and can, at least, pursue administrative review of the petition without subjecting themselves to the ordeal of immigration court proceedings. Treaty traders and investors have no opportunity for administrative review at all, since they must obtain E visas prior to making application for admission and the law makes no provision for the review of a consul's decision.

Hopefully, the consultations required by NAFTA Article 1605 will eventually give rise to the implementation of meaningful administrative review procedures for all Canadian and Mexican business persons seeking entry pursuant to NAFTA. This will be of obvious benefit to the business persons and will further the interests of the United States, Canada and Mexico in promoting the establishment of transparent criteria for temporary entry, which, in turn, will inevitably facilitate the desired trade.

Endnotes

1. 58 Fed. Reg. 69205 (30 December 1993).
2. 63 Fed. Reg. 1331 (9 January 1998).
3. 8 U.S.C. § 1101(a)(15)(B).
4. 8 U.S.C. § 1101(a)(15)(E).
5. 8 U.S.C. § 1101(a)(15)(L).
6. 8 U.S.C. § 1101(a)(15)(H)(i).
7. 8 U.S.C. § 1153(a)(3).

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Statutory Enforcement of International Arbitration Awards in the United States

By H. Stephen Harris, Jr. and Jack P. Smith, III

I. Introduction

The dramatic increase in international commerce and trade in recent decades has resulted in an increased use of arbitration as the preferred form of dispute resolution in transnational business transactions. Reasons for reliance on arbitration in this context are well known, including lower cost than litigation (though this advantage can be overstated), avoidance of parallel litigation in two or more jurisdictions and the risk of inconsistent determinations in multiple fora, greater control of the parties over procedures and over the timing and scope of an award, and greater involvement of the parties in the selection of the decisionmakers.

Arbitral tribunals, however, have neither the authority nor the means to enforce their awards. Once an arbitral award is rendered, unless the parties or assets against which enforcement is sought happen to be located in the jurisdiction where the award is rendered, the victor must resort to the courts of the jurisdiction where meaningful enforcement can be effected.

U.S. practitioners increasingly find themselves asked to obtain, from U.S. courts, enforcement of arbitral awards rendered outside the United States. While there remain unclear areas and splits in authority among U.S. courts on certain subjects regarding the enforcement of foreign awards, there is a basic foundation on which to counsel clients seeking to enforce a foreign award here.

The two principal sources of law are the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (known commonly as the New York Convention) and the Inter-American Convention on International Commercial Arbitration Awards (known commonly as the Panama Convention). As seen below, the non-enforcement provisions of the two conventions are essentially identical. As explained in the section on the Panama Convention, below, which convention applies in a given case depends on whether the parties involved have executed both conventions or only the Panama Convention. This paper seeks to provide an overview of the principal provisions of these conventions, and decisions that illustrate the current application of those provisions by U.S. courts.

II. Enforcement under the New York Convention

A. What Constitutes a Foreign Arbitral Award under the New York Convention?

The most frequently applied (and thus most frequently litigated) source of law on the enforcement of foreign arbitral bodies is the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly known as the New York Convention, which was effected to ease the use of arbitration in the international commercial context.[1] The New York Convention is codified, along with the U.S. Federal Arbitration Act (FAA), in Title 9 of the U.S. Code at 9 U.S.C. §§ 203 *et seq.* (For purposes of simplicity, and because most international practitioners refer to the New York Convention in this way, references to the provisions of the New York Convention will be cited in this paper as Articles of the Convention, not as sections of the FAA.)

Article I of the New York Convention provides for two major categories of arbitral awards falling within its purview: (i) those "made in the territory of a State other than the State where the recognition and enforcement of such awards are sought"; and (ii) those "not considered as domestic awards in the State where their recognition and enforcement are sought."[2] This language marks a compromise between the civil law and common law drafters of the treaty, whose legal systems have traditionally utilized different standards of determining whether an award is domestic, and the provision allows a nation considerable leeway in determining what awards will be considered foreign for purposes of recognition and enforcement.

Why is an award's characterization as "foreign" important? Foreign arbitral awards are governed exclusively by the New York Convention. National judiciaries are not supposed to interpose national law—even national constitutional law—over the privileges and obligations set out in the Convention. This construction guarantees that parties seeking enforcement of foreign arbitral awards accrue certain rights and privileges vis-à-vis the national judicial system in which enforcement is sought. A Belgian court considering the enforcement of an award, for example, must apply the same (or at

least very similar) legal considerations as would a U.S. court in a similar position.[3] In contrast, domestic arbitral awards are not governed by the New York Convention and so are subject to the idiosyncrasies of the various national arbitration laws.

Two instructive decisions clarify the New York Convention's applicability to awards when enforcement in the U.S. is sought. In *Sigval Bergesen v. Joseph Muller Corp.*,[4] the court determined that the Convention would apply to arbitration between two foreign parties, even if the arbitration was conducted inside the U.S. and using U.S. law. The court defined "foreign" as follows: "made within the legal framework of another country, e.g., pronounced in accordance with foreign law or involving parties domiciled or having their principal place of business outside the enforcing jurisdiction."[5] The Second Circuit's approach is thus quite broad and accords with the Convention's aim of making arbitration between parties of different nationalities a more reliable dispute resolution procedure.

In *Industrial Risk Insurers v. M.A.N. Gutehoffnungshuette GmbH*,[6] the court reinforced the *Sigval Bergesen* decision by holding that the Convention would apply to arbitral awards rendered in the U.S. under U.S. law even if only one of the parties to the arbitration was foreign. Conversely, the FAA limits application of the New York Convention when the arbitration is entirely between citizens of the U.S. In that situation, the New York Convention will apply only if the "relationship involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states."[7]

Moreover, the award must be the product of arbitration. It may not proceed from an arbitration-like proceeding actually conducted under the auspices of a state court system, a process available in some countries (specifically, Italy's *arbitrato irrituale*).[8]

Finally, the arbitral award must be "mutual, final, and definite" to be enforced. As stated by the court in *Puerto Rico Maritime Shipping Authority v. Star Lines Ltd.*,[9] "the award must resolve all the issues submitted to arbitration, and determine each issue fully so that no further litigation is necessary to finalize the obligations of the parties under the award."[10] This comment does not mean that partial arbitral awards may never be enforced, for example, in the context of a preliminary award on some certain issue while additional facts are developed necessary for the rendering of the final award. Even so, the courts are wary of such partial decisions; the adjudicated issues must be clearly separable from the non-adjudicated issues, and the issues must be factually and circumstantially distinct.[11]

B. Grounds for Refusing to Recognize and Enforce a Foreign Arbitral Award under the New York Convention

Article V of the New York Convention provides the grounds on which a court may decline to recognize and enforce a foreign arbitral award. The grounds are separated into two categories: those that are procedural and those that are pertinent for reasons of national legal sovereignty.

1. Procedural Grounds (New York Convention Article V(1))

The New York Convention sets out the following five categories of procedural grounds for declination of recognition and enforcement.

a. Incapacity and invalidity. An award may be held procedurally unenforceable on grounds of incapacity of the parties, or invalidity of the arbitration agreement under national law to which the parties have subjected it, or, if no choice of law is provided, under the law of the country where the award was made.[12]

When a petition for enforcement comes before a court, the court must first determine the standard of review to utilize in reviewing the arbitral decision. The U.S. courts have recognized a "pro-enforcement bias" in the Convention. As such, the party opposing enforcement will bear the burden of proving that the award is not entitled to recognition under Article V.[13]

Furthermore, when reviewing an arbitrator's findings, the court will not disturb them unless they were made in "manifest disregard" of the applicable law as set down in Art. V(1)(a). Indeed, if the arbitrator's decision provides a "colorable justification for the outcome reached," the court will accept it as rendered.[14] In general, the U.S. courts are reluctant to re-adjudicate a matter formerly in arbitration unless the arbitrator's failure to apply the governing law is obvious.

b. Inadequate notice. An award will be unenforceable if the party against whom the award was rendered was not given adequate notice of the appointment of the arbitrator or of the arbitration proceedings, or was otherwise unable to present his case.[15] It has long been recognized that parties, in agreeing to submit to arbitration, sacrifice some of the niceties of legal process that accompany litigation in state court. As Learned Hand wrote in 1944,

> Arbitration may or may not be a desirable substitute for trials in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about

> with those procedural limitations which it is precisely its purpose to avoid.[16]

As such, courts often reject complaints that a party was unable to present his case adequately, unless some obvious standard of due process has been violated. In *Firm P. (U.S.A.) v. Firm F. (Germany)*,[17] the German court refused to enforce an award rendered in the U.S. for due process reasons. The American party submitted a letter of evidentiary significance to the arbitrator without also providing a copy to the German party, and the arbitrator subsequently declined to consider a statement authored by the German party (albeit without knowledge of the U.S. party's evidentiary submission to the arbitrator) on the same subject. Although noting that "only in extreme cases, where a party [has] not been able to present his case in an arbitration abroad, would the basic principles of German legal order be violated," the court found that such an extreme case existed in that instance because of the arbitrator's failure to follow basic rules of fair adjudication.

Courts have also considered cases where one party failed to meet its notice requirements to the other party, such as, for example, in failing to provide the exact names of the appointed arbitrator(s) in advance.[18] In general, parties to an arbitration should ensure that form is followed, including adherence to the rules of whatever arbitration institution may be designated as governing the arbitration. Otherwise, enforcement could be jeopardized.

c. Awards covering subjects outside the submission or outside the competence of arbitrators. An award is not enforceable to the extent that it deals with a matter not contemplated by or submitted to arbitration,[19] or contains decisions beyond the competence[20] of the arbitrators, provided that those parts of the award that do fall within the scope of arbitration may be recognized and enforced if they are separable from the matters without the scope of arbitration.[21]

This provision is construed narrowly to comport with the "powerful presumption that the arbitral body acted within its powers."[22] A clear error on the part of the arbitrator in exceeding his authority will be required to obtain non-enforcement under this provision.

d. Improperly constituted tribunal. A foreign award will be rendered unenforceable where the composition of the arbitral tribunal was not in accordance with the parties' agreement, or not in accordance with the law of the nation in which the arbitration took place.[23]

This provision is important because of differences in the two modes of conducting arbitrations. In the traditional, civil model mode, all arbitrators are neutral, must be approved by both parties, and are not expected in any way to "advocate" on behalf of a certain side during the deliberations in which the arbitral panel arrives at its award. In the "American" mode, three arbitrators are present: one chosen by each party, who is expected to take up for the side he loosely represents, and one neutral arbitrator, usually the chair of the tribunal, agreed upon by both parties. Obviously, if the parties are without a mutual understanding on how the arbitral panel is to be composed, unfairness in the final decision could result.

On a related note, if an arbitrator resigns, this can also render the arbitral award unenforceable. In *Ivan Multinovic PIM v. Deutsche Babcock AG*, the Swiss Federal Tribunal considered a case in which one of the three arbitrators resigned before an award was made. The Court refused to enforce the award, finding that the tribunal was improperly composed and thus in violation of the Code of Civil Procedure of the Canton of Zürich (and presumably the New York Convention).[24]

e. Non-binding nature of award. An award is unenforceable under the procedural provisions of the New York Convention if the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, the award was made.[25]

An award has not yet become binding if it is yet subject to some form of arbitral appeal or further consideration on the merits. (Recall, however, that partial awards may in some instances be enforced.) Furthermore, the mere initiation of an action to set aside an arbitral award will not satisfy the requirements of the provision.[26]

A U.S. court will use its discretion to determine whether a foreign court's suspension of an arbitral award was appropriate and whether the suspension will be granted res judicata effect in the U.S. under principles of international comity. In *Chromalloy Aeroservs. v. Arab Republic of Egypt*,[27] the court considered an arbitral award that had been set aside by an Egyptian court because the arbitrators had failed to distinguish between Egyptian civil and administrative law, and furthermore determined that the difference between the two was immaterial for purposes of the dispute. In rejecting Egypt's petition to recognize the Egyptian decision and not enforce the arbitral award, the court determined that the arbitrator's decision was at worst "a mistake of law" and thus not subject to review by the court. The appropriate standard for over-

turning the arbitral panel's decision is "manifest disregard" of the law, in accordance with the pro-arbitration policy of the U.S. courts and of the New York Convention, and the court determined that no such disregard had occurred.

Additionally, the court noted that the language of Article V allows that enforcement "may be refused" by a national court if one of the provisions of the article is satisfied. Emphasizing the permissive nature of the language, and moreover commenting that failure to enforce is "extraordinary [in] nature," the court cited to the French language version of the Convention, also official, that states that "[r]ecognition and enforcement of the award *will not be refused . . . unless. . . .*" The court ruled to reject Egypt's petition for recognition of the Egyptian court's judgment and to recognize and enforce the award in the U.S.

This decision illustrates the lengths to which U.S. courts will go to preserve the public policy favoring arbitration, even to the extent of alienating a foreign judiciary and risking the recognition of U.S. judgments abroad.

2. Grounds Pertaining to National Judicial Sovereignty (New York Convention Art. V(2))

Article V(2) of the New York Convention contains two additional bases on which a court may refuse to enforce an award, as follows:

a. Non-arbitrability of subject matter in forum jurisdiction. The Convention provides that a court may refuse to enforce a foreign arbitral award where the subject matter of the dispute is not capable of settlement under the law of the forum country (*i.e.*, the jurisdiction of the court from which enforcement is sought).[28]

Certain matters are resistant to arbitration. In *Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire Co.*,[29] the court addressed the non-arbitrability of penal laws. In reducing the amount of interest on an award granted by the arbitral panel, the court found that the interest rate initially utilized by the panel, based on French law, was penal rather than compensatory and thus not subject to recognition in a U.S. court. Other non-arbitrable matters might include those of family law, particularly decisions pertaining to child custody and related non-fiscal family issues.[30] In general, however, the pro-enforcement policy of the U.S. courts will necessarily limit the conditions under which an award will go unenforced for this reason. Furthermore, relatively few matters of international commercial interest are likely to invade these areas of law.

The substantive scope of matters regarded by U.S. courts as non-arbitrable has been steadily shrinking. In the watershed decision *Mistubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[31] the Supreme Court determined that claims arising under the Sherman Act[32] could be subjected to arbitration, notwithstanding the special U.S. policy considerations involved in matters of competition law. Characterizing its move as "shak[ing] off the old judicial hostility to arbitration," the Court declined to find that a panel of Japanese arbitrators could not fairly and impartially apply U.S. antitrust law to the commercial dispute in question.[33]

b. Public policy. The New York Convention specifically recognizes the ability of a court to refuse enforcement on the grounds that enforcement of the award would be contrary to the public policy of the enforcing country.[34]

In theory, the public policy provision gives courts perhaps the most leeway in deciding not to enforce an arbitral decision. Nevertheless, this provision is invoked very sparingly. "An expansive construction of this defense would vitiate the Convention's basic effort to remove preexisting obstacles to enforcement," and, furthermore, "conditions of reciprocity . . . counsel courts to invoke the public policy defense with caution lest foreign courts frequently accept it as a defense to enforcement of arbitral awards rendered in the United States."[35] Accordingly, "[e]nforcement of foreign arbitral awards may be denied on this basis only where enforcement would violate the forum *state's most basic notions of morality and justice*."[36]

III. Enforcement under the Panama Convention

The Panama Convention, codified at 9 U.S.C. §§ 301–307, was drafted to provide a framework for international commercial arbitration in the Western Hemisphere. Its non-enforcement provisions, located at Article 5, echo the New York Convention almost exactly. Indeed, only three of the nineteen signatories to the Panama Convention have not also ratified the New York Convention.

The provisions of 9 U.S.C. § 305 set out the relationship between the Panama Convention and the New York Convention by mandating that

> (1) If a majority of the parties to the arbitration agreement are citizens of a State or States that have ratified or acceded to the Inter-American Convention and are member States of the Organization of American States, the Inter-American Convention shall apply.

> (2) In all other cases the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958, shall apply.[37]

Courts have recognized the essentially identical nature of the enforcement provisions of the Panama Convention and New York Convention. Consider *Employers Ins. of Wausau v. Banco de Seguros del Estado*,[38] in which the district court affirmed an arbitral award rendered under the Panama Convention in favor of the plaintiff. On appeal, the defendant averred that it had received insufficient notice of the arbitration proceedings. The Seventh Circuit affirmed, noting,

> As the district court noted, since both the United States and Uruguay are also signatories of the [New York Convention] . . . unless a majority of the other retroconcessionaires [reinsurance firms] are also signatories of the Inter-American Convention, the New York Convention would actually apply to this dispute. . . . However, as we discuss below, the provisions of both conventions are interpreted to reach the same result in each case, and, lacking knowledge of the signatory status of the home states of the remaining retroconcessionaires, the parties have stipulated that the Inter-American Convention shall apply. Since the outcome would not be affected if we instead applied the New York Convention, we agree with the district court that "the point appears to be technical."[39]

Consider also *Skandia America Reins. Corp. v. Caja Nacional de Ahorro y Segoro*,[40] in which, although both plaintiff (U.S.) and defendant (Argentine) were citizens of signatory nations to the Panama Convention, the court applied the provisions of the New York Convention and made no mention of the Panama Convention in its opinion. Although an analysis under both conventions would yield the same result, as noted above, 9 U.S.C. § 305 specifies that the Inter-American Convention will govern arbitration agreements in which a majority of the parties are citizens of states that have ratified the Panama Convention. The court was apparently unaware of this provision.

Endnotes

1. For a thorough discussion of the Convention, and enforcement of arbitral awards generally, see T. Varady, Barcelo, and von Mehren, International Commercial Arbitration (1999).
2. New York Convention Art. I(1).
3. This result drastically increases *predictability* surrounding international commercial arbitration and thus practitioners' *reliance* on the procedure as an effective dispute resolution mechanism.
4. 710 F.2d 928 (2d Cir. 1983).
5. *Id.* at 932 (emphasis added).
6. 141 F.3d 1434 (11th Cir. 1998).
7. 9 U.S.C. § 202.
8. This interpretation of the Convention was rendered by the German Supreme Court in its Decision of 8 October 1991 (*Bundesgerichtshof*). Although not precedent in the United States, the decisions of foreign courts relevant to the Convention are instructive for purposes of understanding how a U.S. court might respond to a similar question.
9. 454 F. Supp. 368 (S.D.N.Y. 1978).
10. *Id.* at 372.
11. *See, e.g., WTB (Germany) v. CREI (Italy)*, 21 Yearbk. Comm. Arb'n 590 (1996) (Bologna, Italy, Court of Appeal 1993) (declining to enforce a final award without considering an earlier-rendered preliminary award because "the two awards are necessarily connected and interdependent").
12. N.Y. Convention Art. V(1)(a).
13. *American Const. Machinery & Equip. Corp. Ltd. v. Mechanised Const. of Pakistan Ltd.*, 659 F. Supp. 426 (S.D.N.Y. 1987).
14. *Andros Compania Maritima, S.A. v. Marc Rich & Co.*, 579 F.2d 691, 704 (2d Cir. 1978).
15. N.Y. Convention Art. V(1)(b).
16. *American Almond Prods. Co. v. Consolidated Pecan Sales*, 144 F.2d 448, 451 (2d Cir. 1944).
17. 2 Yearbk. Comm. Arb'n 241 (1977) (Hamburg, Germany, Court of Appeal, 3 April 1975).
18. *See, e.g., Danish Buyer v. German Seller*, 4 Yearbk. Comm. Arb. 258 (1979) (Cologne, Germany, Court of Appeal, 1976) (declining to enforce award for that reason).
19. In *First Options of Chicago, Inc. v. Kaplan et ux. & MK Investments, Inc.*, 514 U.S. 938 (1995), the Supreme Court addressed the issue of *Kompetenz-Kompetenz*, that is, whether the arbitrators are competent to determine whether the arbitration clause granting them jurisdiction over the dispute is binding. Determining that the best approach was to allow the parties to arbitration to specify in the arbitration clause where such competence lies, the Court noted that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so." *Id.* at 939.
20. It should be noted that in international legal usage, the term "competence" refers to an arbitrator's jurisdictional reach, not his skill level. This distinction is occasionally lost to Americans.
21. N.Y. Convention Art. V(1)(c).
22. *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier (RAKTA)*, 508 F.2d 969 (2d Cir. 1974); *Mgmt. & Tech. Consultants S.A. v. Parsons-Jurden Int'l*, 820 F.2d 1531 (2d Cir. 1987) (enforcing an arbitral award despite averment that arbitrator acted outside the borders of his specified competence, remarking that "[t]he letter agreement indicates that 'any dispute' which could not be 'settled amicably' would be resolved by arbitration. We construe the word 'any' broadly.").
23. N.Y. Convention Art. V(1)(d).
24. Swiss Federal Tribunal, First Civil Section, 30 April 1991, BGE la 166, as discussed in Schwebel, *The Validity of an Arbitral Award Rendered by a Truncated Tribunal*, ICC Int'l Ct. Arb'n Bull. (Nov. 1995).
25. N.Y. Convention Art. V(1)(e).

26. *Southern Pacific Props. (Middle East) Ltd. v. Arab Republic of Egypt*, 24 Int'l Legal Materials 1040 (1985) (District Court of Amsterdam, Netherlands, 1984).

27. 939 F. Supp. 907 (D.D.C. 1996).

28. N.Y. Convention Art. V(2)(a).

29. 484 F. Supp. 1063 (N.D. Ga. 1980).

30. This conclusion comports with the disallowance under the Model Rules on Ethics of contingency fee arrangements in criminal cases and domestic relations cases. In cases regarding these subjects, the law is anxious to ensure that no diminution of due process occurs.

31. 473 U.S. 614 (1985).

32. 15 U.S.C. §§ 1–7.

33. *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942), *quoted in* 473 U.S. at 638. The arbitration clause actually specified the applicable law as that of Switzerland, but the ICC, in its *amicus curiae* brief to the court, stated that it would be unlikely that the arbitrators would apply Swiss antitrust law (which differs in some significant respects) instead of U.S. antitrust law to the dispute. 473 U.S. at 637 n.19. The *Mitsubishi Motors* decision was criticized by Genevese attorney Jacques Werner, who published an article proposing that the price the community of international arbitrators had to pay for the *Mitsubishi Motors* decision, that is, agreeing to subject the dispute to U.S. law in apparent contradiction of the arbitration agreement, was too high and corroded parties' ability to specify the applicable law of their choice. 3 J. Int'l Arb'n 81 (1986), *quoted in* T. Varady *et al*., note 1 *supra*, at 244. Sigvard Jarvin, General Counsel of the ICC, responded to Werner's criticism by saying

> According to leading French and German authorities, there is a growing tendency of international arbitrators to take into account the antitrust laws and other mandatory legal rules expressing public policy enacted by a state that has a significant relationship to the facts of the case, even though that state's law does not govern the contract by virtue of the parties' choice or applicable conflicts rules.

Varady *et al*., note 1 *supra*, at 245.

34. N.Y. Convention Art. V(2)(b).

35. *Parsons & Whittemore*, note 22 *supra*, 508 F.2d at 974.

36. *Id. See, e.g., Firm P. (U.S.A.) v. Firm F. (Germany)*, note 17 *supra* (noting that the decision would not be enforced because the arbitrator violated "basic principles of German legal order").

37. 9 U.S.C. § 305. For a decision applying the Panama Convention, see *Productos Mercantiles E Industriales, S.A. v. Faberge USA, Inc.*, 23 F.3d 41 (2d Cir. 1994) (applying decision in *Sigval Bergesen*, note 4 *supra*, to arbitrations conducted under the auspices of the Panama Convention).

38. 199 F.3d 937 (7th Cir. 1999).

39. *Id.* at 942 n.1. *See also International Ins. Co. v. Caja Nacional de Ahorro y Seguro*, 2001 WL 322005 at *3 (N.D. Ill. 2001) ("The grounds for vacating an arbitration award under the [Panama Convention] are essentially the same as those stated above for the New York Convention); *Empresa Constructora Contex Limitada v. Iseki, Inc.*, 106 F. Supp. 2d 1020 at 1024 (S.D. Cal. 2000), *quoting* H.R. Rep. No. 501, 101st Cong., 2d Sess. 4 (1990), as follows:

> The New York Convention and the [Panama Convention] are intended to achieve the same results, and their key provisions adopt the same standards, phrased in the legal style appropriate for each organization. It is the Committee's expectation, in view of the fact that the parallel legislation under the Federal Arbitration Act would be applied to the Conventions, that courts in the United States would achieve a general uniformity of results under the two conventions.

40. 1997 WL 278054 (S.D.N.Y. 1997).

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