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PRACTICUM: FORM AND POLICY

The *International Law Practicum* is a semi-annual publication of the International Law and Practice Section of the New York State Bar Association. The *Practicum* welcomes the submission of articles prepared by practicing attorneys. The length of an article, as a general rule, should not exceed 3,500 words, footnotes included. Shorter pieces, notes, reports on current or regional developments, and bibliographies are also welcomed. All manuscripts must be sent in laser printed triplicate accompanied by a 3 1/2" disk formated in Microsoft Word or WordPerfect to: The *Practicum*, c/o Daniel J. McMahon, Esq., New York State Bar Association, One Elk Street, Albany, N.Y. 12207-1096. Both text and endnotes must be double-spaced. Endnotes must appear at the end of the manuscript and should conform to *A Uniform System of Citation* (the Harvard Bluebook). Authors are responsible for the correctness of all citations and quotations. Manuscripts that have been accepted or published elsewhere will not be considered. The *Practicum* is primarily interested in practical issues facing lawyers engaged in international practice in New York. Topics such as international trade, licensing, direct investment, finance, taxation, and litigation and dispute resolution are preferred. Public international topics will be considered to the extent that they involve private international transactions or are of general interest to our readership.

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International Trademark Protection in the United States and the European Community

By L. Donald Prutzman

I. Introduction

Despite rapidly increasing globalization in most aspects of trade and commerce today, the international protection of trademarks remains primarily a local country-by-country process. There are a few exceptions—most notably the CTM trademark registration that covers the entire European Community. United States businesses that want to protect their trademarks in other countries have historically had to file individually in each country where protection is desired. In contrast, most European countries are signatories to at least one of a pair of multilateral treaties that permit multi-country trademark applications. The United States has recently ratified one of those treaties, which will give U.S. trademark owners new options for international protection of their marks.

Under current law, international protection of trademarks can quickly become very expensive for a United States business. Each registration in a foreign country costs at least $1,500 to $1,800, including the foreign filing fee, attorney's fees, or fees of a trademark agent, in the country involved, and usually fees of a United States law firm (or the cost of resources of an in-house legal department) to coordinate and supervise the international protection program. European businesses fare somewhat better because of the availability of international applications. However, these still involve substantial filing fees, and are in effect merely a method of applying for registration in multiple countries with one document. Thus, businesses on both sides of the Atlantic need to think through carefully and plan exactly what international protection they need and can afford.

An American or a European business that plans to sell goods or provide services in other countries should take steps to protect its trademarks in each of those countries in advance of shipment of goods or provision of services. Businesses also need to understand that, as their brands become popular in their home countries, even before they are ready to expand internationally, enterprising individuals in other countries will seek to get whatever rights they can in emerging brands in hopes of being able to capitalize when the brands reach those countries. Thus, ideally, businesses should begin to obtain international protection as early as possible in the countries of greatest interest. Which countries these are will, of course, depend on the nature of the goods or services, and the plans of the business.

To understand how to plan for international trademark protection most efficiently and cost-effectively, it is important to have a basic understanding of the framework of international agreements that regulate the process of trademark protection throughout most of the world. Over the last one hundred years, there has been a continuing, if somewhat punctuated, effort to establish international standards for trademark protection. We do not yet, however, have anything approaching a centralized or truly international method of trademark protection. Numerous individual or country group registrations are still required. This is similar to patent protection, but in marked contrast to copyright protection, which is secured throughout most of the world, including the United States and European countries, merely by fixing the work in a tangible medium of expression. Hopefully, there will be increasing recognition that modern commerce occurs in a "global village" and would be greatly facilitated by truly international trademark protection. But that is not the world we live in today.

II. Overview of International Agreements for the Protection of Trademarks

A. The Paris Convention for the Protection of Industrial Property

The first broad-based international agreement concerning recognition of the trademark rights of foreigners in signatory countries was the Paris Convention of 1883. It has been revisited and reconsidered six times since then, most recently at Stockholm in 1967, and amended most recently in 1979. One hundred sixty-four countries, including virtually all those of commercial significance, are contracting states under the Paris Convention, or members of the "Paris Union."

The basic tenets of the Paris Convention have continued to this day as the fundamental principles of all international trademark recognition and protection. They are as follows.

1. National Treatment

The principle of "national treatment" is basically that each member country will afford the same intellectual property rights to foreigners that it affords to its citizens. Article 2(1) of the Convention provides that:

> Nationals of any country of the Union shall, as regards the protection of industrial property, enjoy in all the

> other countries of the Union the advantages that their respective laws now grant, or may hereafter grant, to nationals, all without prejudice to the rights specially provided for by this Convention. Consequently, they shall have the same protection as the latter, and the same legal remedy against any infringement of their rights, provided that the conditions and formalities imposed upon nationals are complied with.

Note that "national treatment" does not require reciprocal treatment. A country need not provide foreigners any trademark protection if it provides its own citizens none. This has been considered a significant weakness in the Paris Convention.

2. No Domicile Requirement

The Paris Convention prohibits any contracting country from requiring that a foreign entity establish a domicile or permanent presence in a country as a condition to enjoying the protection of its trademark laws.

3. Right of Priority

The Paris Convention created the very important right of priority for foreign trademarks. Under the Convention, the filing date of a duly filed trademark application in one of the countries of the Union can be claimed as a right of priority in another country any time within six months of the original filing date. Under this right, a United States trademark registrant who files an application in another signatory country within six months of the U.S. filing has priority in that country over anyone else who filed for the same mark after the U.S. filing date. The same is true for European trademark owners. For this reason, it is important to diary the six-month priority date for each filing, and encourage the client to file before that date in any countries where the need for foreign protection is then reasonably anticipated.

4. Registration

Under the Paris Convention, each country may determine by its own laws the conditions for filing and registration of trademarks, although later international agreements discussed below have standardized some of the requirements and procedures. There is no centralized filing under the Convention. Thus, in the absence of some other agreement, a trademark owner must file and register in each country where protection is needed.

5. Protection of "Well-Known" Marks

One other important provision of the Paris Convention (Article 6 bis) requires the protection of "well-known" trademarks, even if they are not registered in a particular country. Countries are required "to refuse or to cancel the registration, and to prohibit the use, of a trademark which constitutes a reproduction, an imitation, or a translation, liable to create confusion, of a mark considered by the competent authority of the country of registration or use to be well known in that country as being already the mark of a person entitled to the benefits of this Convention and used for identical or similar goods." Owners of well-known marks must be afforded at least five years from the registration of the offending mark in which to request cancellation, but the time in which prohibition of use of the offending mark must be requested is in each country's discretion.

B. The Madrid Agreement Concerning the International Registration of Marks

As noted, the Paris Convention did nothing to establish a centralized or uniform system for international filing and registration of trademarks. In 1891, some of the Paris Union countries made an effort to do that in the Madrid Agreement, but still retained the principle of trademark territoriality—that trademarks and trademark protection only exist in individual countries.

The Madrid Agreement allows trademark registrants in member countries to secure registration in any other member countries they wish by filing an international application through the home country trademark office, with the International Bureau, today the World Intellectual Property Organization (WIPO) located in Berne. Individual countries must, however, approve each country registration based on their own national laws, and oppositions can be filed in each individual country. However, successful opposition in any one country does not vitiate registrations in other countries resulting from the application. Thus, the Madrid Agreement provides a single place to file for multiple national registrations, but the filing alone does not confer any substantive rights and each country processes the application according to its own law and procedures.

Today, fifty-two countries participate in the Madrid Agreement, but the United States has never been one of them. The only way a U.S. company can take advantage of the Madrid Agreement is to have a subsidiary located in a member country register the mark there, and base an international application on that registration.

There are several reasons why the United States and some other countries, most importantly the U.K., Ireland, Denmark and Greece, have always refused to join the Madrid Agreement:

- It requires that a home country *registration* be issued before the international application can be filed. This disadvantages U.S. trademark appli-

cants, and those in countries that have an examination-based trademark system, rather than a mere filing system, because examination is more rigorous, and takes longer, than mere filing-based registration.

- Under the Madrid Agreement, individual countries have only twelve months in which to reject a registration requested in the international application. The process simply takes longer in the U.S. If the U.S. undertook to examine Madrid Agreement applications in twelve months, it would have to give them priority over applications from its own citizens.

- The Madrid Agreement requires that "central attack" be allowed. This means that if the home-country registration (on which the international registrations are based) is successfully attacked, in whole or in part, within five years of registration, all the protection resulting from the international application ceases completely. This is unfair to United States trademark owners because there are many more grounds to attack a registration available in the U.S. than in most other countries.

- The Madrid Agreement does not require any use of, or intent to use, a trademark before filing for registration. Use-based protection of trademarks is a fundamental tenet of United States trademark law. Even though we now allow intent-to-use applications, U.S. registrations cannot be issued until actual use of the mark is demonstrated.

C. The Madrid Protocol

The Madrid Agreement could never establish a truly international trademark system because it would never be acceptable to the United States and a handful of other important countries including the United Kingdom, Ireland, Denmark and Greece. The World Intellectual Property Organization (WIPO) continued to look for a solution that would bring these countries into the fold. A promising 1973 attempt called the Vienna Trademark Registration Treaty was acceptable to the United States, but failed to gain enough support to be viable. Only the Soviet Union, Togo, Burkina Faso, Congo and Gabon ratified it. It is still technically in existence, but has little practical effect.

Finally, in 1989, a "Protocol Relating to the Madrid Agreement Concerning the International Regulation of Marks," known as the "Madrid Protocol" was agreed upon. The Madrid Protocol was thought to be acceptable to virtually all the major players, and the international trademark community thought that a true international trademark system was finally at hand.

The Madrid Protocol treated a number of the problems that the United States had with the Madrid Agreement. The principal differences between the Madrid Agreement and the Madrid Protocol are:

- *Application Based on Filing*—The Madrid Protocol allows an international application to be based on the *filing* of a national trademark application, rather than the perfected national *registration* that the Madrid Agreement requires. This helps ameliorate the disadvantage at which the Madrid Agreement placed United States trademark owners.

- *More Time to Refuse Registration*—The Madrid Protocol gives each country named in an international application eighteen months in which to review and refuse registration, rather than the twelve months the Madrid Agreement affords. This more fairly allocates the resources of the Unites States Patent and Trademark Office.

- *"Central Attack" Less Drastic*—Under the Madrid Protocol, if the basic national registration (or application) supporting the international application is successfully attacked, then the international registrations that stemmed from it may be converted into separate national registrations with an effective filing date as of the original international application's filing date. Under the Madrid Agreement, these international registrations are simply wiped out. This diminishes the draconian effect of "central attack."

- *Fees in Each Country*—The Madrid Protocol allows each national trademark office to charge its national filing fee for examining applications made via an international application.

The Madrid Protocol gained significant acceptance and today has fifty-six contracting countries. However, the United States has not been one of them. That is about to change. The legislation necessary for the United States to join the Madrid Protocol was passed on 2 November 2002, and will become effective on 2 November 2003. At last United States trademark owners will be able to enjoy its benefits. The United States never had any substantive problem with the Madrid Protocol: Political issues not directly related to its provisions caused the long delay in acceding to the treaty. The Madrid Protocol will offer U.S. trademark owners a new, more efficient and less expensive way to protect their marks in many commercially important countries. However, there will be some significant gaps. Neither the Madrid Agreement nor the Madrid Protocol have any contracting countries in the Western Hemisphere (except the United States) or the Middle East, and there are a few in Asia and Africa.

Some U.S. lawyers fear a significant loss of international trademark work from the ratification of the Madrid Protocol. However, most likely the focus of the work will simply change from country-by-country applications to international applications filed through the Patent and Trademark Office. There will still be a number of country-specific issues to consider and important strategic issues concerning whether, and where, to seek international trademark protection. Foreign lawyers in Madrid Union countries also fear a loss of business from U.S. trademark owners and their lawyers, because foreign applications would be filed through the U.S. Patent and Trademark Office, rather than lawyers or agents in each country. This may occur to an extent, but there will still be many instances where U.S. trademark owners will want to file individual country applications.

D. GATT 94 and the TRIPS Agreements

The "General Agreement on Tariffs and Trade," or "GATT," is a multilateral trade agreement originally reached in 1947 to restore and expand pre-World War II levels of international trade, and reduce the high tariffs and quantitative trade restrictions the war had left. There have been seven additional "rounds" of GATT talks since 1947, each of which addressed various issues.

The "Uruguay Round," concluded in 1994, included an intellectual property annex and established the World Trade Organization (WTO) among other accomplishments. The TRIPS (Trade Related Aspects of Intellectual Property Rights) Agreement, part of the Uruguay Round, established substantially higher standards of protection for intellectual property and provided for enhanced enforcement of that protection. With respect to trademarks, TRIPS accomplishes the following:

- Establishes minimum standards for protecting trademarks in member countries and provides for enforcement of those standards. Recall that the Paris Convention only requires national treatment: it does not require a member state to protect trademarks at all.
- Specifies that any signs, including personal names, letters, numbers, figurative elements and color combinations capable of distinguishing the source of the goods or services may be trademarks, even if their distinctiveness is not inherent, but acquired through use. Registration may, however, be conditioned on visual perceptibility.
- Provides that registration may be conditioned on use (as it is in the U.S.), but filing before actual use must be allowed.
- Mandates that an application may not be refused solely because the intended use has not commenced within three years from filing.
- Requires that trademarks must be published before registration or promptly thereafter, and that other member countries must be afforded a reasonable opportunity to oppose registration or seek cancellation.
- Gives a registered trademark owner the exclusive right to prevent unauthorized third parties from using the mark, or a close imitation, on identical or similar goods or services, where likelihood of confusion would result.
- Expands the protection given to "well-known" marks under Article 6 bis of the Paris Convention. In determining whether a trademark is "well-known," knowledge of it in the relevant public sector must be considered, including knowledge obtained from promotion in international trade. The protection also extends to use of the well-known mark on goods or services other than those for which the mark is registered if such use would indicate some connection with the registered mark likely to cause damage to the owner.
- Requires a minimum initial trademark registration term of seven years, and an indefinite number of subsequent renewal terms of at least seven years.
- Provides that if a member country requires use of a mark to maintain registration, three years of continuous non-use without a valid reason for non-use is the minimum requirement for cancellation. Use of a mark by a third person subject to the owner's control must be recognized as use sufficient to maintain registration.
- Allows member states to determine the conditions of trademark assignment and licensing, but prohibits compulsory licensing of trademarks.

It is important to note that TRIPS does not harmonize national trademark laws, it merely sets minimum standards. Nor does it attempt to change the principle of territoriality, under which trademarks are recognized and controlled on the national level.

TRIPS is binding on all of the one hundred eight (at last count) members of the World Trade Organization, and on the European Union.

E. The 1994 Trademark Law Treaty (TLT)

The Trademark Law Treaty, negotiated in 1994, addresses procedural issues only. It establishes common

procedures for national trademark filing and registration, the most important of which are the following.

- Establishment of the maximum procedural requirements that a member country may impose prior to (i) granting a filing date, (ii) issuing a trademark registration, or (iii) recording an assignment or license.
- Creation of eight standardized international application forms, which all trademark offices must accept.

The TLT applies to "marks consisting of visible signs, provided that only those Contracting Parties which accept for registration three-dimensional marks shall be obliged to apply this Treaty to such marks" and to "marks relating to goods (trademarks) or services (service marks) or both goods and services." Significantly, it does not apply to "hologram marks and to marks not consisting of visible signs, in particular, sound marks and olfactory marks." Collective, certification and "guarantee" marks are also excluded.

The TLT currently has fifty-one members and is still open.

F. The Nice Agreement

The Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks, originally reached in 1957 at Nice, France, established the international classes into which marks are classified for registration in most countries. Most of the world now uses the international classes, but there are exceptions. Particularly when searching trademarks, it may be important to know when a country changed to the international classes, and what system it used before the change. For example, Japan changed to international classes fairly recently, and has not revised the classes for marks registered before the change. Accordingly, when a search in Japan turns up a mark and a class number (typically with no listing of goods and services, or with goods and services in Japanese), it is difficult to tell whether the mark is registered in the international class that is the object of the search, or in the former, *sui generis* Japanese class, which may be for goods or services vastly different from the object of the search.

The Nice Agreement was recently amended. The amendment replaced former International Class 42 (miscellaneous service marks) with four new specific service mark classes.

G. The Pan American Convention

The Pan American Convention of 1929 is of virtually no significance today, but is sometimes referred to. It consists of two separate agreements, the "Convention for Trade Mark and Commercial Protection," and a Protocol on Inter-American Registration of Trade Marks. Fourteen Western Hemisphere countries, including the United States, but notably not Canada, participated in this convention. It provided for national treatment and centralized filing and registration, and was similar in many respects to the Paris Convention and the Madrid Agreement. It was administered by the Inter-American Trade Mark Bureau, located in Havana, which is now closed. The United States renounced the Protocol portion of the Convention in the mid-1940s.

III. Supranational Trademark Protection

In addition to trademark protection through national registration or international registration under the Madrid Agreement or Madrid Protocol, it is sometimes possible to seek trademark protection covering a specific group of countries by filing for one of the several supranational trademarks or registrations that are available, the most important of which is the European Community Trademark or CTM.

A. The Community Trademark

The Community Trademark (CTM) covers the entire European Union, currently consisting of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. It will likely soon include the Czech Republic, Slovakia, Hungary, Estonia, Poland and Cyprus. The EU will soon expand to include additional countries.

The CTM is a unitary right that is obtained by a single registration procedure filed in a single office and governed by a uniform law. It is administered by the Office for Harmonization of the Internal Market (OHIM) headquartered in Alicante, Spain. The procedure is relatively new, but seems to be working well. If a CTM registration is granted, the mark is protected throughout the European Union, even if it is only used in part. To maintain a CTM registration, the mark need be actually used in only one member state. However, to get a CTM registration, the mark must be available and registerable in each member state. National trademark offices can reject applications on absolute grounds, or for conflict with marks registered in that country, or registrants in individual countries can oppose registration in the OHIM. However, if the CTM registration is rejected because the mark is not registerable in a member country, the application can be converted into national applications in the countries desired.

If a trademark owner has applied for a United States registration, the priority of that filing date may be asserted in the CTM application by filing a copy of the U.S. application filing receipt. However, one procedural growing pain has created a "Catch 22" that attor-

neys should be aware of. Under current procedure, the United States Patent and Trademark Office not only permits, but strongly encourages, electronic filing of applications, but issues only an electronic filing receipt by e-mail. The OHIM however, has no procedure for accepting electronic filing receipts in support of priority of a U.S. application, and the USPTO has no procedure for issuing paper receipts for electronically filed applications. This will be worked out somehow, but the solution is not yet at hand. Accordingly, if a CTM application is anticipated soon after filing in the U.S., a copy of the application should be ordered from the Trademark Office promptly so that a "priority document" will be available to establish priority in the OHIM.

The CTM, national registrations and international registrations each have their advantages and disadvantages, which are summarized below. Each situation requires careful analysis to determine the best course of action for a particular trademark or trademark owner.

1. The CTM

Advantages

- Relatively inexpensive to obtain compared to national registrations or international application (after payment of filing fees in each country). (But quite expensive if protection is really needed in only one or two EU countries.)
- Currently covers fifteen countries and that number will grow.
- Use in one country is sufficient to maintain the CTM mark in all EU countries.
- Long-term cost advantage because there is only one mark to maintain and renew.
- Can be enforced through a pan-European injunction.

Disadvantages

- Relatively slow proceeding—registration takes thirteen to sixteen months even when no problems come up.
- Enforcement not available before registration.
- Relatively high risk of failure, since rejection by one country dooms CTM application: it can be converted to national applications, but with the disadvantages noted below.

2. National Registrations

Advantages

- Fastest way to obtain protection in individual countries (depending somewhat upon the country in question).
- Cost advantage if protection in only one or two countries is needed.

Disadvantages

- Most costly alternative for protection in most or all of the EU countries.
- Greater burden of maintenance and renewal for individual marks.
- Can obtain enforcement in only one country.

3. International Registrations Under the Madrid Agreement or the Madrid Protocol

Advantages

- Most cost-effective way to obtain protection in a large number of countries where many non-EU countries are involved.
- Lower maintenance burden than national registrations because a single renewal or single assignment will be effective for all.

Disadvantages

- Very costly in the event that problems arise in a few countries because of need for a representative and separate proceedings in each country.
- Results in a bundle of national rights rather than a unitary right.
- Mark must be used in each country at some point to maintain protection in each country.
- Mark must be enforced in each country separately.
- Generally not available in the Western Hemisphere or Middle East and limited availability in Asia and Africa.

4. Discussion

The choice of national registration, international registration or CTM registration is not exclusive. The three systems co-exist and a trademark owner may find it most efficient to use each of them to some extent to achieve the needed protection in the most cost-efficient manner.

For example, a United States trademark owner that needs international protection might choose to file an international application covering France and the U.K. (EU countries where prompt protection is needed) and Poland, the Czech Republic, Slovakia and Hungary, as current non-EU countries. The same owner might want to file national applications in Canada and Mexico (which are not Madrid Agreement or Madrid Protocol countries), because shipments to these countries are scheduled to commence very soon, and also file a CTM

application to cover future expansion into other EU countries. Once the CTM mark is obtained, the French and U.K. international registrations could be dropped, but the savings would be minimal.

Thus, it is not at all clear that, now that the United States has ratified the Madrid Protocol, all U.S. trademark owners will opt for an international registration covering the EU countries rather than a CTM registration. The choice will depend on the needs, plans and budget of the individual trademark owner and will differ depending on the circumstances. Further, it is clear that Madrid Union applications will not satisfy all trademark protection needs.

Another factor that will play a role in the determination of which system to use in which country is the breadth of the description of goods or recitation of services desired. This is because there is a fundamental difference in approach to this aspect of a trademark application between the U.S. and many other countries. The U.S. Patent and Trademark Office is quite restrictive and often requires applicants to narrow, or make more specific, the description of goods in the application. In contrast, the OHIM and many national trademark offices are far more expansive, often allowing applicants to recite the entire litany of goods described in an international class under the Nice Agreement. If a U.S. applicant files an International Application under the Madrid Protocol in the U.S., any restriction of the description of goods that the U.S. Patent and Trademark Office subsequently requires will also apply to the other countries in the International Application. This effect can be avoided if individual national applications, and/or a CTM application, are filed in the first instance. This would result in broader protection for the mark in countries other than the U.S.

B. The Benelux Trademark

The three Benelux countries, Belgium, The Netherlands and Luxembourg, have a common trademark law administered by the Benelux Trademarks Office. The main office is located in The Hague, Netherlands, and there are national offices in Brussels, Belgium, and Luxembourg. Applications may be filed with any of the three offices. This system has been in existence since 1962. In contrast to the CTM, there are no separate national trademark offices for the three constituent countries. A Benelux registration is good in all three, and there is no such thing as a separate national registration for any of them.

C. The African Intellectual Property Organization (OAPI)

Twelve African nations have formed a unified trademark territory called the Organisation Africaine de la Propriété Intellectuelle. The offices of the OAPI are located in Yaoundé, Cameroon. Benin, Burkina Faso, Cameroon, the Central African Republic, Chad, Congo, Gabon, Guinea, Ivory Coast, Mali, Mauritania, Niger, Senegal and Togo are member states of OAPI. Trademarks registered in any of the member countries are valid in all of them. The OAPI maintains a Web site at www.oapi.com.

D. The African Regional Industrial Property Organization (ARIPO)

Another group of fourteen African countries, Botswana, The Gambia, Ghana, Kenya, Lesotho, Malawi, Mozambique, Sierra Leone, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe, has formed a common filing system known as the African Regional Industrial Property Organization. ARIPO is headquartered in Harare, Zimbabwe. It operates under a treaty known as the Banjul Protocol on Marks. ARIPO applications can be filed with the ARIPO office in Harare, or with the national offices of any of the member states. An ARIPO application is similar to a Madrid Agreement or Protocol application in that it designates the specific countries in which protection is desired. The application and documents are in English and the fees are payable in U.S. dollars.

E. The Andean Community Legislation on Industrial Property—Decision 486

Effective 1 December 2000, the Andean Community, consisting of Peru, Colombia, Venezuela, Ecuador and Bolivia, has adopted a "common regime on intellectual property" known as Decision 486. With respect to trademarks, Decision 486 establishes a common trademark law among this group of nations (although there is some room for national law variations), and gives applicants and registrants in one member country the right to register their trademarks in other member countries with priority based on the first registration, and the right to oppose registrations of confusingly similar marks in other countries.

Decision 486 grants National Treatment to all members of the Andean Community, and all member states of the World Trade Organization or the Paris Convention. The decision also grants most favored nation status to all member states of the WTO or the Paris Convention by providing that "any advantage, favor, privilege, or immunity granted by a Member Country to the nationals of any other Andean Community Member Country shall be extended to the nationals of all other Members" of the WTO or the Paris Convention.

Under Decision 486, the first application filed in an Andean Community Member Country, or with a national, regional or international authority "to which the Member Country is related by a treaty establishing an analogous right of priority to that established in this

Decision," is entitled to claim priority in an Andean Community country based on the earlier filing. Claims of priority must be made within six months of the original filing, and a declaration supporting priority must be filed within three months thereafter.

The scope of the types of trademarks allowed under Decision 486 is expansive. For example, all "[s]igns that are susceptible of graphic representation may be registered as trademarks." including specifically sounds and smells, "the shape of a product its packaging or wrappings," and "a color delimited by a specific shape, or a combination of colors." The new legislation also contains some enlightened provisions protecting the rights or sensibilities of indigenous peoples and other "communities." For example, it forbids registration of trademarks that "consist of the name of Indigenous, Afro-American, or local communities, or of such denominations, words, letters, characters, or signs as are used to distinguish their products, services or methods of processing, or that constitute an expression of their culture or practice, unless the application is filed by the community itself or with its express consent."

Although registration in one Andean Community country does not automatically give protection in all, registrants or applicants in any member country are expressly granted standing to oppose registration of marks confusingly similar to theirs in any other member country. However, such cross-border opposers must "demonstrate real interest in operating in the market of the Member Country where they are filing an opposition by applying for registration of the trademark [in such member country] at the moment they file their opposition."

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International Title Insurance

By John E. Blyth

I. Introduction

The use of international title insurance in international transactions is of very recent origin. To one trained in sound U.S. business practices, reliance on international title insurance is a logical and prudent extension of those sound business practices. To one trained in civil law business practices, however, introducing international title insurance into a transaction seems, at least initially, unnecessary and a waste of time and money.

These two differing reactions to the use of international title insurance stem primarily from (i) the different systems used in the United States and in civil law countries to record or register interests in real property ("immovable," as opposed to "movable" property, as a civil law lawyer or notary would say), and from (ii) the conclusions that may be drawn about those interests once they have been recorded or registered. By way of contrast to the recording systems used in the United States (except where the Torrens System is still in effect), registration of an interest in real property with the proper authority in a civil law country is a virtual guaranty that the interest is exactly as stated; there is, therefore, no need to look behind the registration.

The purposes of this article are (i) to describe the coverages of some of the most widely used international title insurance policies available today and then (ii) to determine if their use would add value to a real property transaction in a civil law country. To assist in this determination, a questionnaire was sent randomly to several foreign lawyers and notaries known to the author. Fifteen responded from eleven countries.

The questionnaire is reproduced at Appendix 1-A. The responses are summarized at Appendix 1-B. The names and addresses of the foreign legal experts are included at Appendix 2, so that they may be contacted directly if further information is desired about a particular foreign jurisdiction. The author is deeply grateful to these ladies and gentlemen for sharing their time and talents.

II. Types of International Title Insurance Policies

The types of international title insurance policies now being offered by United States-based title insurance companies and their affiliates are the International Owner's Policy and the International Loan Policy.[1] For some countries, the International Owner's Policy also includes an Owner's Leasehold Policy and a Lender's Loan Policy. These policies are modeled after the familiar ALTA policies, but the differences between the international and domestic ALTA policies are striking and sometimes surprising.

As will be seen, the companies that write international title insurance are extremely proprietary, sometimes copyright their products, and sometimes refuse to answer questions or to share information (except subject to a confidentiality agreement). This is an emerging field of endeavor and the companies are understandably protective of their products.

III. Types of Transactions

The present use of international title insurance policies is primarily limited to commercial transactions, the larger the better. Policies for residential transactions are not yet generally offered.

One notable exception to the foregoing statement concerning residential policies is Canada.[2] Indeed, some United States practitioners, whose clients purchase or mortgage residential property in Canada, outside of the Province of Québec, state that the use of a Canadian residential title insurance company is much faster and cheaper than the use of a Canadian lawyer. In Québec, title insurance has existed for the past five-to-six years. It has acted as a complementary regime of protection for professionals, such as lawyers and notaries, and has also provided needed security to purchasers. In addition to compensating holders for title defects, encumbrances, and fraud, title insurance policies also cover faults arising from the breach of zoning regulations, errors by land surveyors, negligence of attorneys, and unmarketability of title.[3]

Another notable exception to the statement concerning residential transactions is Mexico. The efforts in that regard of Stewart Title Guaranty Company, described below, are extensive.[4]

IV. The Underwriters

The underwriters now active in the international title insurance arena[5] include First American Title Insurance Company, Lawyers Title Insurance Corporation (LTIC), Stewart Title, and Chicago Title Insurance Company.[6] A partial list of contacts at these companies is contained at Appendix 3. There are undoubtedly other companies that offer similar products.

V. Where Offered

International title insurance is offered by different companies in a remarkably large number of countries in the world. See Appendix 4. Even though this insurance

is offered in so many places, it is not uncommon to find foreign attorneys and notaries who are not aware of its existence. Even if they are aware of its existence, their initial reaction to international title insurance is often one of outright rejection.

VI. Cost

Unlike ALTA policies offered in the United States, the cost of international title insurance policies varies widely from company to company and from country to country. There are minimum premiums that may be as low as $3,000 and as high as $50,000. The policies may also contain deductibles. See Appendix 5.

VII. Analysis and Comparison of International Title Insurance Policies: the Similarities

International policies as they existed in the year 2001 are similar to ALTA policies in both style and substance (see, e.g., the insuring provisions and the policy sections entitled "Exclusions from Coverage," and "Conditions and Stipulations"), as indicated by the following.

- The opening paragraph of the insuring provisions provides as follows:

  > SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B AND THE CONDITIONS AND STIPULATIONS, [name of company], herein called the Company, insures, as of Date of Policy shown in Schedule A, against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of:[7]

- In the Owner's Policy, the insurer agrees also to pay the costs, attorneys' fees and expenses incurred in defense of the title, as insured, but only to the extent provided in the Conditions and Stipulations.[8] In the Loan Policy, the insurer agrees also to pay the costs, attorneys' fees and expenses incurred in defense of the title "*or the lien of the insured mortgage*, as insured, *subject to the deductible provided for in Schedule C, and*" (not "but") only to the extent provided in the Conditions and Stipulations.[9]

- The Loan Policy tracks the coverages contained in the traditional ALTA Policy.[10]

VIII. Analysis and Comparison of International Title Insurance Policies: the Differences

A. Insuring Provisions: The notable differences in the insuring provisions are as follows.

- Only *legal* title is insured.[11] There is no *marketability* coverage in most policies. According to the several foreign experts who responded to the Questionnaire, marketability of title is not generally recognized as a "legal concept" in civil law jurisdictions.[12]

- Only a *recorded*[13] defect, lien, or encumbrance on the title is insured against. There is no mechanic's lien coverage. Mechanic's liens are not recognized in Latin America.[14]

- The *legal* right of access is insured.[15]

- First American's policy, like Stewart Title's newest product, insures against several additional matters.[16] Although these matters are generally understood to be included in a standard ALTA policy, they are undoubtedly included in the international policy to enhance the desirability of the policy for the prospective purchaser who may not understand that these matters in the United States are automatically included coverages.

B. Exclusions from Coverage: The notable differences in the Exclusions from Coverage are as follows.

- The Exclusions from Coverage are changed to match up with changes made to the insuring provisions, such as marketability, recorded matters,[17] and mechanic's liens.

- The Exclusions from Coverage are broadened to include terminology such as rules, orders and decrees, of the nation and province.

C. Conditions and Stipulations: The notable differences in the Conditions and Stipulations are as follows.

- The Conditions and Stipulations are changed to match up with changes made to the insuring provisions, such as marketability, recorded matters, and mechanic's liens.

- The Conditions and Stipulations contain the following additional changes:
  - The continuation-of-coverage provision is eliminated. Under a continuation-of-coverage provision, coverage of the policy continues in force, inter alia, so long as the insured has liability by reason of covenants of warranty made by the insured in any transfer or conveyance of the estate or interest.
  - Payment of loss is to be in U.S. dollars or in the U.S.-dollar equivalent of the currency in which the loss occurred.

- Trial by jury is not permitted in any of the policies.
- Arbitration is mandatory.[18]
- Choice of law is stated as that of:
  - New York,[19] or
  - California.[20]
- Choice of forum (venue) is as follows:
  - New York, Chicago, Los Angeles, Houston and Miami,[21] or
  - California.[22]

D. Schedule C—Deductible: All loss, as well as costs and attorneys' fees incurred in the duty-to-defend provision are subject to a deductible set forth in Schedule C of the policy.[23]

E. United Kingdom: The coverages provided by title insurance policies in the United Kingdom are not uniform and are difficult to summarize. See Appendix 6 for details.

IX. Underwriting Standards, Searching, and Regulation

Underwriting decisions for international title insurance policies are generally made in the United States, with some local exceptions. For First American, the decisions are made in Santa Ana, California, except for Canadian properties (as to which the decisions are made in Canada) and properties in England, Wales, Scotland, and Northern Ireland, as to which the decisions are made locally. Stewart Title sometimes follows the same local practice.

For searching title, most companies employ local counsel or agents of their own familiar with the local situation and then rely upon title opinions from those local counsel or agents. A representative of First American informed the author that it relies on an opinion from a local law firm in the country in which the title is being insured. For English properties, for instance, it hires solicitors in whom it has confidence. If it were insuring in the Czech Republic, it would hire a Czech law firm.

All of the title companies issuing international title insurance allege that they are regulated, but this statement bears further investigation.

X. The Value of International Title Insurance

A. The Skeptical Civil Lawyer

A civil law attorney or notary[24] is initially extremely skeptical about the value to be added to a real estate transaction in his or her country by the use of international title insurance because, in the vast majority of cases, the existing civil law registration system already provides all necessary title assurances for the transaction.

Ownership interests (not title alone) in real property, together with the encumbrances against that real property, are registered in a local registration office. A notary or his designee makes an examination of the records, and the information revealed by that examination is accepted as true. The government guarantees the accuracy of the information contained in the registration office, and, in the opinion of the civil law attorney or notary, there is no need to look further or to ask for anything more.

Alessandro Macri, an Italian attorney (*praticante avvocato)* with an LL.M. from Cornell Law School, consulted three Roman notaries on the subject. They saw no need for title insurance in a commercial real estate transaction, except in two instances. For those two instances, a title insurance company would likely take an exception anyway. See Appendix A-1. Olivier Panhard, a French *Notaire*, also with an LL.M. from Cornell Law School, stated flatly that there was no need for title insurance in France.

Not all countries, however, have fully developed and reliable land ownership registration systems. In these countries, if the title company is willing to take the risk, opportunities exist for the use of familiar title insurance coverages. During the existence of the former German Democratic Republic (from 1949 to 1990), the then-authorities routinely obliterated preexisting records with liberal applications of India ink. During the existence of the former Soviet Union, private ownership of real property ceased to exist.[25] Prior to the formation of the Czech Republic, private ownership records were carelessly maintained.[26] Even in a sophisticated state such as Israel, it is not rare to find defects concerning surface and boundaries if the registrations were inherited from books maintained during the period of Ottoman rule and the properties have not yet been subjected to the process of "parcelation."[27]

In addition, some international investment and financing players from the United States take comfort, as a matter of prudence, from the presence of a familiar title insurance policy and therefore demand it as a part of the transaction.[28]

The responses to the Questionnaire that were received from the foreign attorneys and notaries should be consulted for a detailed discussion of the effects of land registration in the particular country. Those effects are very different in a civil law jurisdiction when compared with the effects of land recordation in the United

States. That said, there are some general principles that may be distilled from the responses, and they may be summarized as follows:

1. Registration of an interest in real property at the appropriate registration office is presumptive evidence of ownership of that interest. Rebutting that presumption is extremely rare because (i) much care is taken to make the proper registration in the first place, and (ii) the grounds for rebuttal are more theoretical than real (mistake, fraud, duress, incompetency, and the like).

2. Protections afforded the equivalent of a bona fide purchaser for value in civil law countries are widely recognized and are alive and well. The concept of "first in time, first in right" is also generally recognized.

3. The costs of remedying a defective registration are usually borne by the person who made the error: the notary (who is required to carry insurance) or the registration office (i.e., the government).

4. The need to correct a defect in registration varies from a short to a long time, depending upon the severity of the error.

5. Damages are available to an injured party, but there does not seem to be a uniform pattern with respect to the amount of damages available. Specific performance does not appear to be an available remedy.

6. Even in the most sophisticated civil law countries, mistakes are theoretically possible. The prudent investor in foreign real property is therefore properly counseled to inquire into the added value of international title insurance.

B. The Title Industry's Response

Marietta Morris Maxfield of Stewart Title Guaranty Company, who has written about the advantages that an international title insurance policy can bring to a transaction,[29] makes the following points:

1. Title insurance speeds up marketplace transactions and provides a reliable foundation for the securitization of mortgage-backed securities.

2. Canadian banks customarily use title insurance to protect against title-related problems and to satisfy their clients with a cost-effective, speedy alternative to the traditional solicitor's title opinion.

3. Because of extensive real estate investment losses in Mexico, U.S. investors have been increasingly demanding title insurance for their investments in Mexican real estate. One such loss occurred in October 2000, when twenty-three homesites were ordered returned to a Mexican private company, the legally recognized owner, because the land had erroneously been titled twice by the government in 1952. A title examination would likely have revealed the error and a title insurance policy would have provided coverage for damages to an injured owner and would have provided that owner with legal representation in the extended court battle.

4. Solicitors who examine title in the United Kingdom face the problem of a gap of weeks, perhaps months, between the conclusion of a search and the closing of a mortgage or conveyance. A local search may entail a delay of several weeks, cost more than one hundred pounds, and fail to provide a guarantee against adverse entries that are made before the mortgage is completed.

5. In some countries, such as Israel, the continuous influx of immigrants and the rapid building of condominiums by Housing Companies have created an overwhelming flood of paper work. The process of recoding with Israel's TABU (the land registration system), as reported in 1996, was too laborious and long, with the result that many deeds have not been officially registered, an Israeli requirement for the perfection of real property rights.

6. Examiners face the problem of unrecorded documentation affecting title. In a few countries, documents in the public register or the public records are not accessible to the general public without the owner's consent or a court order.

7. The limited indemnity amount provided by some land registries for negligent recording falls far short of compensating the lender or purchaser for the economic loss suffered due to the recorder's negligence.

C. Title Insurance as a Credit Enhancement

A British solicitor[30] recently told the author that U.S. financing of a London transaction was made possible when an international title insurance policy became available. The lender did not look to the title insurance for the traditional assurances concerning title. Rather, the lender viewed the presence of the title insurance policy as a credit enhancement, similar to a guaranty or letter of credit, which made the transaction sufficiently attractive so as to induce the lender to participate and to permit the transaction to go forward.

An experienced United States practitioner would not fault the reasoning of the British solicitor. Indeed, a

prominent New York City lawyer[31] routinely obtained title insurance policies for his clients in foreign transactions some fifteen years ago—long before such policies became fashionable, if that is the correct expression. He informed the author that, because there was so much money riding on those transactions and because he and his client were never completely satisfied as to the requisite clerical skills of the local registration personnel, he wanted "someone riding with me."

Endnotes

1. In the case of Lawyers Title Insurance Corporation (LTIC), there is what is referred to as a "Commitment for Title Insurance (International)."
2. First American Title Insurance Company, the California corporation, together with its subsidiary First Canadian Title Company Limited, is licensed in all provinces in Canada. The underwriting decisions for Canada are made in Canada.
3. *See* Bernard Moreau, Appendix 1-B.
4. *See, e.g.*, Mitch Creekmore's several writings for Stewart Title at www.stewart.com.
5. In addition to the companies mentioned here, an Internet search for "international title insurance" turned up Old Republic Title Insurance Company, but that Web site does not contain any evidence of international products. ("There is no catalog.")
6. The policies of Chicago Title Insurance Company are copyrighted by Fidelity National Financial, Inc., its parent.
7. This is the same language contained in a standard ALTA Owner's Policy and Loan Policy. The language is also identical in the First American, LTIC, Stewart, and Chicago Title International title insurance policies.
8. These provisions are identical in the policy forms of First American, LTIC, Stewart, and Chicago Title.
9. LTIC's Owner's Policy. The other companies do not include any mention of a deductible.
10. These are as follows:

    (5) The invalidity or unenforceability of the lien of the insured mortgage upon the title;

    (6) The priority of any [in LTIC, recorded] lien or encumbrance over the lien of the insured mortgage; and

    (7) The invalidity or unenforceability of any assignment of the insured mortgage, provided the assignment is shown in Schedule A, or the failure of the assignment shown in Schedule A to vest title to the insured mortgage in the named insured assignee free and clear of all [in LTIC's policy: "recorded"] liens.

11. First American's policy insures against title being vested other than as stated in Schedule A. "Title" is defined as the estate or interest in the Land described in paragraph 2 of Schedule A.

    LTIC's policy insures against legal title to the estate or interest described in Schedule A being vested other than as stated therein.

    Stewart's policy insures against title to the estate or interest described in Schedule A being vested other than as stated therein.

    Chicago Title's policy insures against title to the estate or interest described in Schedule A being vested other than as stated therein.

12. Marketability of title in the United States is commonly defined as the quality of title that a buyer would be willing to accept or which an unwilling buyer could be forced to accept. One Swiss attorney observed, however, that the system of registration in Switzerland provides a buyer with the virtual equivalent of marketability of title as that concept is understood in the United States. See Dr. Thomas Rihm in Appendix 1-B.
13. LTIC uses the word "recorded." First American, Stewart, and Chicago Title do not.
14. See LTIC's policy.
15. First American's policy insures against the lack of a right of access to and from the Land.

    LTIC's policy insures against lack of a legal right of access to and from the land.

    Stewart's policy insures against lack of a right of access to and from the land.

    Chicago Title's policy insures against lack of a right of access to and from the land.

16. *See, e.g.*, the following: (i) forgery, fraud, undue influence, duress, incompetency, incapacity or impersonation affecting the Title; (ii) restrictive covenants on the Title limiting use of the Land; (iii) others having rights arising out of leases, contracts or options on the Title; (iv) an easement or right of way on the Title; (v) unauthorized transfers or conveyances of the Title by a corporation, partnership, trust limited liability company or other legal entity; (vi) the invalidity of any document upon which the Title is based because it is not properly executed, sealed, acknowledged, notarized, delivered or Recorded; (vii) the invalidity of any document upon which the Title is based because it was executed under a falsified, expired or otherwise invalid power of attorney; (viii) the invalidity of any conveyance or transfer of the Title because it was derived through a defective judicial or administrative proceeding; (ix) the invalidity of any conveyance or transfer of the Title derived through a decedent's estate; (x) estate or inheritance tax liens on the Title; (xi) and an erroneous or inadequate legal description of the Land affecting the Title. (Capitalized terms are as used in the policy.)
17. "Public Records," in First American's policies, are those records maintained by a governmental or quasi-governmental agency in which Mortgages, deeds and other documents that convey title to the Land must be Recorded in order to provide actual, constructive or deemed notice of their contents to purchasers and/or mortgagees of real property for value and without Knowledge. For First American policies issued in England and Wales, the phrase means records established by the Crown or any Local Authority at Date of Policy pursuant to the Land Registration Act 1925, the Land Charges Act 1972 and the Local Land Charges Act 1975 (all as amended at the Date of Policy). (Capitalized terms are as used in the policy.)

    In the LTIC and Stewart policies, "Public Records" are records established under the statutes of the nation, state, province or district where the land is situated at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge. (Capitalized terms are as used in the policy.)

    In the Chicago Title policies, "Public Records" are those records in offices or registries maintained by authority of a governmental agency in which the conveyances of the title to land and mortgages and encumbrances on that title must be recorded, filed or registered either to establish their validity or to give notice to potential purchasers of the land of their existence.

18. See LTIC's policy. In First American's Policies for Western Canada, however, either the insurer or the insured may demand arbitration.

19. See LTIC's policy. A sampling of the policies indicates that New York is generally regarded as the international choice of law. Chicago Title provides that all disputes shall be determined only by a state or a federal court of competent jurisdiction located in the state of New York, without recourse to any principle of conflict of laws or comity.

20. See First American's policy, which provides as follows:

    The court shall (i) apply the Law of the jurisdiction where the Land is located to determine the validity of claims against the Title adverse to the Insured, and (ii) the Law of the State of California in the United States of America in interpreting and enforcing the terms of this policy. In neither case shall the court apply its conflict of laws principles to determine the applicable law.

    For its U.K. policies with U.K. jurisdiction and those in England and Wales, however, First American applies English law in interpreting and enforcing the terms of the policy.

21. See the LTIC policy. Chicago Title provides that the Company is unwilling to have this policy interpreted by, or to subject itself to the laws of, any jurisdiction other than the United States of America and the state of New York.

22. See First American's policy. For its U.K. policies with U.K. jurisdiction, however, First American requires that any litigation or other proceeding brought by the Insured against the Company must be filed only in London, England. England is the domicile of the Company. For its policies applicable in England and Wales, the policies are subject to the jurisdiction of the English courts. (Capitalized terms are as used in the policies.)

23. See the LTIC Commitment, which provides that "[a]ll loss, damage, costs, attorneys' fees and expenses paid pursuant to the terms and provisions of this commitment, and any and all policy or policies issued pursuant to said commitment, are subject to a monetary deductible of twenty-five thousand and no/100 dollars, U.S. $25,000.00."

24. In a civil law country, a notary (*Notar, notaire, notario*, etc.) is trained as an attorney, has generally achieved very good grades, and serves the public in a variety of ways. One of those ways is the preparation of documents necessary to transfer interests in real property and then seeing to it that the transfer is made and registered. The notary does not represent anyone. It is his or her function to make sure that everyone understands the transaction and that it is done correctly.

25. The author, in a 1999 trip to Novgorod, Russia, participated in a conference on the registration of interests in land and observed the beginning efforts of the Ministry of Justice in the Novgorod *oblast* (a region about the size of New York State) to institute such a system of registration. The Minister of Justice (a sometimes uniformed, one-star general) who was in charge of the effort told the author that the system faced many obstacles: lack of computers, lack of people trained in operating computers, lack of maps, and a general hostility on the part of the populace to the registration of those interests in land. Even she, the owner of two apartments, had not yet registered her interests because she did not want to pay the applicable taxes.

    Now that the Russians are becoming good capitalists, however, conditions are changing. Land reform legislation and the increased availability of mortgage financing may create a future need for international title insurance.

26. *See* Stanislav Myslil, Appendix 1-B.

27. *See* David Cohen, Appendix 1-B.

28. The land registration and title certification process in Mexico is a good one, a system similar by definition to that of the "Torrens" system. However, any title defect that can occur in the U.S. can also occur in Mexico with other potential hazards looming on the horizon uncommon in U.S. property conveyances. *Ejidos* claims or expansions, labor liens, *fideicomiso* (Mexican bank trust entitlements), property regularization and permitted use issues can pose significantly detrimental problems to unknowing purchasers of Mexican real estate. Moreover, little or no legal recourse is afforded the purchasing public against the public notary who closes all real estate transactions in Mexico or against Mexico's public registry of property concerning title or lien defects, omissions, gaps in ownership or recording errors. Mitch Creekmore, Director of Business Development for the Mexico Division of Stewart Title Guaranty Company, *Crossing the Title Assurance Border in Mexico*, Arizona Journal of Real Estate & Business (August 1999), reprinted on the Stewart Title Web site, www.stewart.com. Few understand that, in Mexico, not only does a title policy protect against recording errors, liens, encumbrances, encroachments, taxes, and boundary line disputes, but also against fraud, misrepresentation, impersonation, secret marriage, incapacity of parties, and undisclosed heirs. Even the best of *notarios* or attorneys may be unable to discover these title problems. Mitch Creekmore, *Understanding Real Estate in Mexico*, Texas Realtor (May 2001); see also Mitch Creekmore, *When Does Real Estate Close in Mexico?*, Arizona Journal of Real Estate & Business (August 2001); Mitch Creekmore, *Ejidos Land vs. Private Property—What's the Difference?*, Arizona Journal of Real Estate & Business (March 2000).

29. Marietta Morris Maxfield, *Why You Need Title Insurance*, Probate & Property 8 (May/June 2001); Marietta Morris Maxfield, *International Availability of Title Insurance*, American Bar Association Annual Meeting, Orlando, Florida (August 5, 1996).

30. Simon Hardwick, Halliwell Landau, St. James's Court, Brown Street, Manchester M2 2JF, HardwickS@halliwells.co.uk.

31. Anthony B. Kuklin, Esq., Of Counsel, Paul, Weiss, Rifkind, Wharton & Garrison, 1285 Avenue of the Americas, New York, NY 10019-6064, akuklin@paulweiss.com.

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Appendix 1-A

Questionnaire

1. Describe briefly the land registration system in effect in your country, its name, its basis of authority, and how it is maintained.
2. How does the land registration system function? Who are the players?
3. Is the concept of marketability of title a part of your country's land registration system? Does the concept exist in your country?
4. Once title to a real property interest is registered, what is the effect of that registration (i) on the person in whose name the interest is registered, and (ii) on third parties?
5. What would be the effect on the interest in real property if:
   a. it were obtained by means of a forgery or impersonation, or under fraud or duress?
   b. a person transferring an interest in real property were incompetent?
   c. the title document used in the transaction were invalid?
   d. the description of the real property interest were incomplete or inaccurate?
6. How is a mistake or defect in a registration cured?
7. Who pays for curing the mistake or defect in the registration?
8. How long does it take to cure the mistake or defect in a registration?
9. Who pays the holder of the real estate interest for a loss or damage incurred by that holder because of the mistake or defect in a registration?
10. Does the land registration system indicate the value of the real property interest?
    a. Does it indicate the amount paid for the interest, the amount secured by that interest (as in a loan), or the present value of the interest?
    b. When an interest in real property is registered, is any value shown at full or market value or at some lesser amount?
    c. If loss or damage is sustained by an injured party because of a defect in a registration, is the party compensated at a value based on full or market value or at some lesser amount?

APPENDIX 1-B

Responses to the Questionnaire

1. Describe briefly the land registration system in effect in your country, its name, its basis of authority, and how it is maintained.

Germany: The German system of registering interests in land is widely followed in civil law countries throughout the world. Under German law, the transfer of real property consists of three legal acts: *Kaufvertrag* (sales contract), *Einigung* (unity), and *Übergabe* (transfer), all of which require the use of a *Notar* (notary). The actual transfer of ownership and other rights takes place when the transfer is registered in the *Grundbuch* (land registry). There can be no acquisition, no change, and no loss of ownership in real property without an entry in the land register.

The registration system is provided for by the German Civil Code[1] and in the German Code of Civil Procedure.[2] The local registration office is called the *Grundbuchamt,* which is a part of the local courts and is staffed by court clerks and judges. The land register is maintained at the registration office of the local court.[3]

The entire registration process does not take more than a few weeks. Prior to an unconditional entry in the land register, a person may give notice of his or her acquisition or loss of an interest in the parcel by registering a *Vormerkung* (the equivalent of a conditional notice of entry) in the registry.

Austria: The land register (*Grundbuch*) is a public register of land maintained since 1871 by officers of the Austrian federal district courts pursuant to the Austrian Civil Code (*Allgemeines Bürgerliches Gesetzbuch*),[4] with more substantive regulations found in the Land Register Act.[5] Because the *Grundbuch* is a public register, anyone may request an excerpt from it for a fee. Information regarding an owner's name or assets, however, is private so that anyone seeking information on the assets of a person must do so address by address. Although the information is available to anyone, the persons seeking such information must have a justified interest (legal, economic or familial). Each jurisdiction has its own hard copy of the *Grundbuch* but a national electronic version exists as well.

Prior to an actual entry in the land register (*Einverleibung*), it is possible to make two other kinds of entry. One is the conditional entry (*Vormerkung*), similar to the German, and the other is the notice (*Anmerkung*) either of (i) certain circumstances (e.g., the commencement of bankruptcy or the minority of a person), or (ii) specially regulated legal circumstances (e.g., a notice of claim).

The *Grundbuch* consists of two parts: the main register and the archives. Divided into three sections, the register sets forth (i) the description, parcel number and use of the land; (ii) positive easements connected to the land; and (iii) notes regarding official restrictions and encumbrances, ownership, liens, mortgages, easements, charges, purchase options, rights of repurchase, inventory rights, and objective and subjective restrictions. The electronic version includes a cadastral map, which indicates the borders and zoning of the property.

Czech Republic: The land registration system, since 1989, is based on the German-Austrian model. It is managed by the Cadastral Bureau, which is a state body. Prior to 1989, the system was managed by another organization, which had taken it over from court records. In view of the former regime of state and cooperative ownership, not much attention was paid to the accuracy of entries, and it is difficult to make the registration system functional again. Moreover, the system is now being transformed to an electronic system, which brings additional difficulties and delays.

Switzerland: Based on a federal system of registration, each of the twenty-six cantons runs a land registration system that registers ownership rights, mortgages, servitudes, easements, and other interests in real property. Although the registry is a public registry, only an "interested person" has access to the information. Publicly available data include lot number and the real estate lots that are entitled to certain servitudes or easements.

Brazil: An interest in real property (ownership, possession, encumbrances) may not be transferred without registration in the Real Estate Title Registry. Unless registered, the interests are not valid or enforceable.

Québec: The Land Register, created and maintained by the Québec government, is designed to identify all real rights in respect of an identified parcel of land. Additional other rights may also be registered (i.e., a commercial lease). Québec's territory is divided into Registration Divisions, each with its own Registry Office. Each Registration Division contains several Cadastres with a Land Register for each Cadastre. The Cadastre comprises a plan that divides the territory into identified lots. Each lot is assigned a separate page in the Index of Immovables of that Cadastre.

The Index of Immovables is kept by a civil servant, the Registrar. Each entry into the Index of Immovables contains (1) the nature of the document presented, with a reference to the corresponding application; (2) the date of the presentation of the application; (3) the names of the relevant parties; (4) the assigned number of the application; and (5) any other relevant comments. The Index is thus an enumeration of all the real rights, their nature (property, security interest, servitudes, etc.), and their holders, as such information has been received by the Registrar for each lot identified in the Cadastre.

The system of publication of rights is currently being reformed. The reforms are primarily aimed at computerizing the system. As such, the changes have not fundamentally altered the publication of rights in Québec; rather, they have had an important effect on the manner in which rights are publicized and consulted. The basis for the system can be found in Articles 2934 to 3075 of the Civil Law of Québec.

Israel: In order to understand the rules governing real property in Israel, a distinction must be made between state-owned land and privately owned land.

Most of the land belonging to the State of Israel is state-owned land and has never been privately owned or continually possessed by any private entity or person. These lands are administered by a governmental entity established by law, known as the "Israel Lands Administration," popularly referred to as the "Administration." The Administration does not sell state lands, other than in a few exceptional circumstances, but rather leases these lands for forty-nine years, with an option to extend for another forty-nine years.

The remaining land in the country is essentially privately owned.

Titles of ownership in real property must be registered in the land registries according to the Real Property Law, 1969 (the "RPL"), in order to be valid. It should be noted, however, that property owners do not obtain a title deed as they do in many other countries. Leasehold land and rights to leasehold land are registered in the land registries in the same manner as privately owned lands even though the owner is the state. The registries are kept in regional land registration offices established by the Minister of Justice.

The registration of rights is one of the most problematic areas in relation to state lands. The source of the problem lies in the fact that state lands are usually large tracts of land, which were not originally planned or zoned. When a new zoning plan is approved, it normally calls for a subdivision of the existing tract into many smaller plots. Before the rights in the smaller plots can be registered in the land registry, the register must be amended to reflect the new physical boundaries of the plots themselves. This procedure, known as "reparcelation" is rather complicated and involves many different authorities. It may take a number of years to complete. In the meantime it is not possible to register the rights in the new plots.

As an alternative, the Administration itself keeps a register of the rights in the different plots. This alternative does not adequately secure the transferee's right against all possible defects in the title of the transferor, since the RPL relates only to registration in the land registries. It is often necessary, therefore, to make provision for alternative security.

Pursuant to the RPL, rights in real property are registered in three different kinds of registries: (i) the Registry of Bills, in which are registered all the lands that did not go through the reparcelation procedure and which are mainly owned by the state; (ii) the Registry of Rights, in which are registered rights once the reparcelation procedure has been completed; and (iii) the Registry of Condominiums, in which are registered the rights in condominiums.

Italy: The land registration system is called *Sistema della Trascrizione*. The relevant provisions are codified in Articles 2643-2696 of the Italian Civil Code. (All references to "Articles" contained in the responses from Italy to the Questionnaire are references to Articles of the Italian Civil Code.)

It is a race system. Thus, a subsequent purchaser can enforce his right to real property against third parties if he is the first to register. However, a bad-faith seller will be liable for damages towards the first bona-fide purchaser, and the subsequent bad-faith purchaser will be liable for damages towards the prior bona-fide purchaser.

Registration is made and records are kept by the *Ufficio del Territorio* (until last year called *Conservatorie dei registri immobiliari*) where the real property is located. At the time of this writing, it is expected that, as of early 2003, registration will be possible by filing by computer a single document both for tax and registration purposes.

The land registration system is a personal one. Thus, in any *Ufficio del Registro,* where the property is located, the civil law notary has to look for the grantor by name (*sistema personale*), and, once she has found the grantor, she would be able to locate all the real property that the grantor owns in that particular district. To the contrary, in other European countries, such as Germany, a deed has to be traced on the basis of the property (*sistema reale*) and not the grantor. In a few Italian Regions with special statutes (*Regioni a Statuto Speciale*), including Trentino Alto Adige, there is a so-called *sistema reale*. This land registration system is an exception to the general rule. It is based on the real property, like in Germany, and any transfer of real property is perfected through the intervention of a judge (the civil law notary public is not involved in these transactions).

According to Article 2657, only the following documents can be registered: (1) a public deed (*atto pubblico*), i.e., pursuant to Article 2699, a document written, with the formalities required by law, by a civil law notary or a public officer authorized to confer public faith (*pubblica fede*) on the deed; (2) a private writing with an authenticated signature, e.g., authenticated by a civil law notary; (3) a private writing certified by a judge; and (4) judgments and deeds executed abroad, which have to be legalized by an Italian notary, a judge or a public officer.

As per Article 2645-bis, a preliminary contract can be registered at the *Ufficio del Territorio* where the real property is located. This kind of registration produces a "booking" effect (*effetto prenotativo*), so that the final contract will produce its effects retroactively from the date of the registration of the preliminary contract, thus protecting the piece of real property from any claimants after the preliminary contract has been registered.

Pursuant to Article 2651, all judgments affecting the real property must be registered, but, in this case, the burden of registration is on the parties through their attorneys, not on the civil law notary.

According to Article 2652, summonses and complaints involving real estate have to be registered in order to put the world on notice of any claim to the real property or any burden on the parties.

Venezuela: The name of the registry office is the Registry of Real Estate. Registration is done before the corresponding Auxiliary Registry Office. The competent registry office is the one located in the same jurisdiction where the real estate is located.

The bases of authority for the system are the Venezuelan Civil Code and the Venezuelan Law of Auxiliary Registry. The registry offices are independent from the central government in terms of budget, which they raise by imposing fees on the transactions that they carry out.

France: The land registration system is known as *conservation des hypoteques,* which is a state-owned agency with offices throughout the country. Each of these offices has a specific territorial jurisdiction and is managed by a high standard public servant called a *conservateur des hypotheques* whose responsibility it is to record properly all the contracts notified to him that affect or create an interest in land.

The rules applicable to the registration system are derived from the following statutes: *Decret du 4 janvier 1955* and *Decret du 14 octobre 1955*, the purpose of which was to organize accurately the recording system in France.

Mexico: The land registration system was inherited from Spain and is modeled after that in other civil law countries. Historically, the unified land registration system in Mexico was implemented in 1528 as the *Officio de Hipoteca* (Office of Mortgage Recording) through a decree from the Court in Madrid as a worldwide initiative to implement a unified land registration system throughout the Spanish empire that would facilitate mortgage operations. There were earlier systems in place, including land registries from Aztec times, but they are not reflected in the current system.

Today, the registry is entrusted to each of the thirty-one states of the Republic plus the Federal District. Each state is in turn divided into judicial districts, each with a Public Registry Office entrusted with identifying and making known to the general public, through its records, all property and rights over real estate with respect to an identified parcel of land (which include ownership, mortgages, easements, priorities and certain types of tenancies). The system is regulated by state laws that are essentially the same and vary little from state to state. Unlike the system in Italy, the Mexican registry system is mostly indexed by property (*sistema reale*) and not by individual (*sistema personale*), except in certain states. It is a race-to-register system under which only public deeds (those issued under the faith of a notary) may be registered: first in time, first in right.

2. How does the land registration system function? Who are the players?

Germany: There is a separate, unique land register folio for each separate piece of land, and it is divided into three divisions. Division I shows ownership; Division II shows mortgages and land charges; and Division III shows all other rights to the piece of land, such as easements. These records are kept in paper form, but the use of electronic registers is becoming more and more widespread. There is no amending, changing or making any other entry in the land register without a formal application by the land owner or someone else to whom a right in the land has been given. Section 892 of the *BGB* attaches public trust to the register. In practical terms, it is extremely uncommon for the land registry to be factually wrong.

Austria: To enter an ownership record of a new piece of land or to alter the ownership record of an existing parcel of land, an application is made in addition to a contract. The purchaser must formally accept all encumbrances and duties associated with the land; signatures are added before a *Notar*; and the birth dates of all parties are given. For non-EU citizens, the consent of a panel supervising the land transfer also needs to be obtained.

On a theoretical note, the transfer of an interest in real property occurs only when a valid title (*causa* or legal reason or interest, e.g., a sales contract or a testamentary act) unites with a valid method of transfer (method of inheritance or entry into the *Grundbuch*). One without the other is not sufficient.

If the documents are notarized, unobjectionable, and consistent with the register, the application will be approved. The attorney preparing the documents, or the notary certifying them, is responsible for their legal effect. The parties must verify that the information is correct. The judicial grant of an entry presumes that the presented documents are valid and legal. Incorporation into the *Grundbuch* serves to effect the absolute acquisition or loss of rights.

Czech Republic: See the German-Austrian models.

Switzerland: See the German-Austrian models.

Brazil: No response.

Québec: Registration is carried out by filling out an application in the appropriate Registry Office, accompanied by the fees payable. The reform of the publication of rights will enable this process to be entirely effected via the Internet. The application must be made by presenting either (1) the act by which the right is acquired (i.e., a contract of sale) or an authentic extract of that act; (2) a summary setting out the required information; or (3) a notice, in limited cases. These documents generally have to be accompanied by a certificate signed by a notary, a land surveyor, or an officer of justice that states that the identity, quality, and capacity of the parties have been verified.

The Registrar first verifies that the right in question is subject to registration in the Index of Immovables, and that the property is properly identified in the form prescribed by law. He then proceeds to an examination of the form of the application. The Registrar ascertains that the prescribed information

has been included and that the required supporting documents have been presented. He then makes the entries in the corresponding page of the Index of Immovables. Finally, he remits to the applicant a certified statement of the entry he has made. Applications are deemed presented from the time (to the minute) that they are received by the Registrar.

The Index of Immovables is open to the public for consultation upon payment of a nominal fee. With computerization, the consultation will be made available via the Internet.

The major players are (1) the holders of a right, (2) the notary, and (3) the Registrar. It is customary but not required to use a notary in most major immovable transactions. Notaries have the legal obligation of verifying the identity, quality, and capacity of the parties involved in the transaction and of issuing a certificate to be remitted with the registration application.

Israel: The head of each land registration office is a Land Registrar appointed by the Minister of Justice under the Real Property Law, 1969 ("RPL"). The Registrar is in charge of the administration of the land registers and has authority, among other things, to register transactions in real property, to register cautionary notes, and to correct clerical errors in the registries. After the execution of a contract for the sale of land or the transfer of any other right, a registered "caution" grants the purchaser preference over any later conflicting transaction by the vendor and also protects him against the vendor's creditors.

Under the RPL, the Minister of Justice also appoints a *Mefakeach* (Supervisor) and a *Memune* (Appointee). The Supervisor is authorized to hear disputes between unit owners in condominiums relating to the management of the condominiums. He has the authority of a judge in the magistrate's court. The Appointee has the authority of a judge in the district court. He is the highest authority over real property in Israel.

The RPL describes five different kinds of rights in real property, which, when transferred to another person or entity, constitute a "transaction" and which must therefore be registered in the land registers. These rights are the rights of *ownership, tenancy, mortgage, easement*, and *priority*.

A tenancy for a period not exceeding ten years does not require registration to be valid. In addition, a title received by way of inheritance does not require registration in order to be valid, regardless of the right granted by the title.

All contracts regarding a transaction in real property must be in writing in order to be valid.

The registration of transactions in real property is relatively uncomplicated once the reparcelation procedure is completed. The registration, providing publicity, is computerized and will show the present ownership and encumbrances on the property, its size, boundaries, and cautions, if any. Information relating to past transactions can also be obtained from the Administration. An extract from the Registry of Rights is considered sufficient proof of the correctness of its contents and is usually necessary to establish the existence of a title before any transaction is conducted.

Italy: The land registration system is funded by the national government. Pursuant to Article 2671 of the Italian Civil Code, the civil law notary has the duty to register within the shortest time possible after closing of the contract.

Pursuant to Article 2650, for the registration to be effective, the chain of title must be perfect. The deed must be registered properly within the chain of title, which refers to that sequence of registered documents capable of providing subsequent takers with notice of those items of record. If a prior deed was not registered and therefore the chain of title is not perfect, the registration is not effective. The notary is liable for an improper registration.

The players are the buyer, the seller and the civil law notary, who represents the transaction.

Venezuela: In a nutshell, the parties to a contract submit the original document that evidences their transaction to the corresponding registry office for its registration and inscription in the corresponding registry book. They pay a fee that is calculated according to the amount of the transaction (i.e., the price of the real estate) in addition to other factors. The next step is for the registry to study the purchase and sale document in order to ascertain whether the real estate belongs indeed to the seller mentioned in the document and whether the real estate is free of mortgages and other pending obligations, and to determine

its dimensions and boundaries. This process takes approximately three days, after which the parties return to the registry office to complete the formalities of the transfer of ownership.

The players are the registry office and the parties to the purchase and sale contract. Normally, it is the buyer who is responsible for all the arrangements and expenses related to the registration process.

France: The purpose of the registration system is basically to give notice to third parties when the contract subject to be recorded affects an interest in land. The system applied in France is more or less the equivalent of the system applied in a common law race-notice jurisdiction. It could be defined as follows: Any conveyance of an interest in land will not be valid against any subsequent bona fide purchaser without notice thereof if that subsequent purchaser's conveyance is first recorded. Note that, unlike in the U.S., there is no "purchaser for value" requirement concerning the price of the subsequent conveyance. The subsequent purchaser must be a "bona fide" purchaser. If the subsequent purchaser had actual or inquiry notice, the purchaser is not bona fide.

In addition, in case of a conflict between two subsequent purchasers, the situation in which neither of them records almost never occurs, and, thus, there is no "notice jurisdiction rule." Before resolving the conflict, a judge always requires that at least one party has recorded.

To be recorded a contract or any act must be drafted in the so-called authentic form. This means that it has to be drafted either:

- by a *Notaire*, the only public official vested with the authority to draft authentic contracts; or
- by some member of the state administration vested with a specific capacity (e.g., *prefets*), especially when the state is a party to the transaction, sometimes on both sides.

If necessary, a judgment rendered by a court that affects an interest in land may be published, because a judgment is per se an "authentic act." This is often encountered when a court seeks to specifically enforce a contract of sale after one of the parties illegally failed to perform.

To be recorded, the contract drafted by the *Notaire* must comply with a high standard of accuracy defined by the statutes mentioned above.

Pursuant to Article 28 of the *decret du 28 janvier 1955,* the following acts and contracts must be recorded in order to provide notice to third parties:

- All contracts amounting to a sale of real estate or of an interest in real estate, and all contracts creating an interest in real estate;
- Any lease having a duration of more than twelve years;
- Any contract amounting to a restraint on alienation;
- All contracts or judicial decisions intending to:
  - Confirm the occurrence of a condition subsequent applying to a sale contract;
  - Rescind a previous contract affecting an interest in land;
  - Organize the respective rights and duties of the parties within a joint tenancy or tenancy in common over real property.

In addition pursuant to the Article 2103 et seq. of the French Civil Code, all mortgages of, and grants of security interests in, land must be registered; otherwise, there is also no notice to third parties of the creditors' rights.

Generally, almost all the contracts intended to be recorded are drafted by a *Notaire* in order to provide the required authenticity. Within two months thereafter, the *Notaire* submits them to the *conservateur des hypotheques* for recording.

Mexico: Each state has divided its territory into different judicial districts. For example, the largest state in Mexico, Chihuahua, is divided into fourteen districts. Each district has a Public Registry office that holds what is called a *Catastro* (a registry of all the land within the district) and from which all proper-

ties are indexed. Thus, the Public Registry offices are inherently local and by their nature make it impossible to carry out a national search, since all searches have to be made at a local level.

The players in the land registration system are the Registrar of the Public Registry Office and the notary.

In a real estate purchase and sale transaction, the players also include the buyer and the seller. The notary, although usually paid by the buyer, does not act as counsel to any of the parties to the transaction. His function is merely to insure that the transaction is carried out pursuant to law. The purchase-and-sale transaction entails an extensive investigation by the notary at the Public Registry Records of the chain of title (which refers to that sequence of registered documents capable of providing notice to subsequent purchasers of the property), as well as of any liens placed on the property. Once the investigation has been made, the Registrar carries out an independent review of his records and issues a certificate of freedom of liens, which is then used in the transaction. Depending on the type of transaction, the notary may file with the Public Registry a note to be inserted in the records advising of the impending transaction, thereby giving notice to third parties about the upcoming transfer of title. Once the purchase-and-sale transaction has been closed and the public deed signed by the notary, the notary has the responsibility to have the public deed recorded in the corresponding Public Registry.

3. Is the concept of marketability of title a part of your country's land registration system? Does the concept exist in your country?

Germany: No and no. Theoretically, however, all rights are marketable if properly registered in the *Grundbuch*.

Austria: No and no. Every encumbrance or possible encumbrance, usually indicated by a controversy note (*Widerspruch*), is known to the purchaser beforehand. The rare exception to that rule is that contracts protected by the Rent Act may have to be tolerated by a purchaser even though they are not visible from the land register. A new owner may not terminate rental contracts made between the previous owner and the tenant.

Czech Republic: No and no.

Switzerland: Applying the definition given under United States law, all real estate titles are basically marketable in Switzerland.

Brazil: No response.

Québec: After conducting a research of the doctrine and jurisprudence, we have been unable to find any comprehensive reference to the notion of marketability of title in Québec. Nevertheless, we have become aware that certain Québec title insurance policies cover loss by reason of unmarketability of title (*non-négociabilité du titre*), a seemingly comparable concept to that of the United States.

Israel: The concept of marketability of a title per se, i.e., whether a reasonable buyer would be willing to accept a title or whether an unreasonable buyer could be forced to accept a title, does not exist in Israel's land registration system.

Italy: The concept of marketability as understood in the United States does not exist in Italy. *Incommerciabilità* (unmarketability) refers to inalienability of property of the state pursuant to Article 823 of the Italian Civil Code.

Venezuela: No.

France: The concept of marketability of title is absolutely not a part of the French registration system. The concept of marketability has nothing to do with the registration system. The *conservateur des hypotheques* under whose responsibility the titles are registered is not required to control the title; he is supposed to register on the merits.

The *conservateur* must refuse to register a transfer of title (for technical reasons only) when the standards of accuracy to be complied with in accordance with the statutes mentioned above are not met, whether or not the title or contract would be considered as marketable under the U.S. standard. Notably, the *conservateur* ensures the accuracy of the names of the parties and the geographical references used in the description of the land (*cadastre*) and further ensures that the contract properly reflects the chain of title. If these rules are not complied with, he can reject the registration. Note that,

unlike in the U.S., if the contract does not reflect the chain of title previously registered, the contract cannot be registered. The *conservateur* can register a contract violating the parties' rights, or the zoning ordinances, or a contract unfairly favoring one party, without incurring any liability. It is not his duty to control the validity of the contracts on the merits. This is the duty of the person drafting the contract, usually a *Notaire*.

As long as the accuracy standard requirements are met, the *conservateur* must register the transfer of title.

Whether or not a purchaser receives the equivalent of marketable title depends to an extent on the *Notaire* because of his duty to secure the informed consent of his clients and to provide for their best interests. He has the duty to draft a valid contract, ensuring that it complies with all the rules concerning zoning, encumbrances, adverse possession and other matters. Because the statute of limitations is thirty years in France, the *Notaire* will recite all of the events recorded in the chain of title over the last thirty years; moreover, the *Notaire* has the resources to perform all the research that is necessary for this.

The *Notaire* has the duty to ensure that the title would be marketable under the equivalent of U.S. standards. In the event of a breach of this duty and if the title is not marketable, the *Notaire* would be professionally liable, and the injured party could assert a claim for damages. Rescission is not applied in this situation unless one of the basic grounds for rescission is met (e.g., mutual mistake, fraud, duress, or unconscionability). The *Notaire* is covered by specific insurance. If a third party successfully claims an interest in the land because the *Notaire* made a mistake in the chain of title recited in the contract, the *Notaire* is liable and his insurance will compensate the injured party. This is why there is no need for title insurance in France.

Mexico: No. The concept of marketability as understood in the United States does not exist in Mexico. The concept of marketability resides in the ability to transfer title. As in the French system, this marketability is verified by the notary through his investigations in the Public Registries.

4. Once title to a real property interest is registered, what is the effect of that registration (i) on the person in whose name the interest is registered, and (ii) on third parties?

Germany: The person in whose name a right is registered in the land register is the owner of that right.[6] The owner of the right and all third parties may therefore rely upon the registration. Even though a registration is wrong, the registration may be relied upon, unless the person so relying knows the registration to be wrong. A third party may therefore acquire ownership "in good faith" from the registered owner even though the registered owner is not in fact the real owner.

Austria: Once the registration is made, the person in whose name the parcel is registered is the true and valid owner. If a property is sold to two different parties, the party first to register is the true owner. Registration is conclusive, irrefutable proof that the named person is the true owner. There exist a few restrictions on the types of land that may be registered, e.g., national parks and rural areas. In addition, if ownership acquired by prescription (*Ersitzung*), then the entry in the *Grundbuch* is only of a declaratory character.

Czech Republic: See the German-Austrian models.

Switzerland: Registered persons and third party persons may rely on the registrations if they are made in good faith.

Brazil: Unless registered, ownership interests in real property are not valid or enforceable.

Québec: The registry does not itself establish title, but publication serves as notice to third parties that such a right presumptively exists.

Rights are made effective *by and between the parties* notwithstanding publication. The inscription of a right in the Index of Immovables creates a simple presumption of the existence of that right as between the parties. This presumption may be rebutted by providing proof to the contrary.

The publication of a right in the Index of Immovables allows that right to be asserted *against third parties*. Rights can only be asserted against third parties once they have been registered. Registration cre-

ates a presumption of knowledge of the rights registered. This presumption may be rebutted but only after it has been shown that the third party was diligent in consulting the Index.

Registration also serves as a marker for establishing priorities among competing rights in the property. In general, rights rank according to the date, hour, and minute that they have been entered into the Index of Immovables. Although publication occurs only upon inscription into the Index, priority is determined according to the time of submission of the application.

Israel: A transaction is not completed, and there is merely an undertaking to conclude a transaction until registration occurs. Prior to registration, the transferee's right is a contractual right only, enforceable between the transferor and the transferee only. After registration, the transferee becomes the beneficiary of a possessory right, affording him protection against third parties and creditors of the vendor, as well as against the vendor himself. Cautionary notes may be registered upon request by an interested party. After registration of a cautionary note, registration of a transaction conflicting with the note is not permitted.

Registration in the Registry of Rights is sufficient evidence of its contents. Registration in the Registry of Bills is, however, only prima facie evidence of its contents and it is therefore possible to bring evidence refuting such registration. Any person may, in a court procedure, seek to deny a title registered in the Registry of Bills if he has sufficient proof supporting his claim. This is not possible for a title registered in the Registry of Rights.

The rules governing conflicting transactions (see below) do not apply to property registered in the Registry of Bills, and the rights of a purchaser in good faith of such a property do not prevail over the rights of the real owners of the title. The only relief available to a purchaser who has suffered loss and damage in that case would be to seek compensation from the responsible parties.

When a person undertakes to perform a conflicting transaction, the rights of the first purchaser in time will be given preference. This rule applies to contractual rights only, i.e., before registration of the title of either party. However, the right of the second purchaser in time will be preferred if the following conditions are fulfilled: (i) he acted in good faith and did not know about the undertaking to perform a transaction made for the benefit of the first person; (ii) he obtained title in the property for consideration; and (iii) the transaction was registered in the land registries (Registry of Rights) in good faith. If a property is leased to one tenant for a period not exceeding ten years, in which case registration is not obligatory, and later leased to another tenant in a conflicting lease, the right of the first tenant in the property will be preferred, unless the second tenant already took possession of the property in good faith.

Italy: Prior to registration, the holder of the ownership interest or other *diritto reale* can enforce her right only against seller, according to Article 1376 of the Italian Civil Code. After registration, the holder can also enforce her rights against third parties, according to Article 2644.

Registration has two purposes: (i) making the ownership right or other *diritto reale* enforceable against third parties, pursuant to Article 2643 of the Italian Civil Code, and (ii) solving controversies among claimants to the ownership right or other *diritto reale* to the same piece of land, pursuant to Article 2644.

It should be noted that in the Italian legal system, pursuant to Article 1376, ownership rights or other *diritto reale* (i.e., ownership interests in real or personal property) are transferred through validly manifested mutual consent, provided that (i) there is a writing evidencing this (otherwise the transfer is null and void), and (ii) the writing is registered, so that it will be enforceable against third parties.

Registration of an ownership interest is called *trascrizione,* whereas registration of a mortgage is called *iscrizione.*

Venezuela: The registration of ownership is effective, for all purposes (*erga omnes*), from the moment of registration.

France: Registration does not affect the relationship with the other party to the contract. As for its effect on third parties, because the interest is registered, the person in whose name title is registered can assert his interest against a third party whose concurrent interest is not registered.

The effect of the registration on third parties is more or less similar to the effect of registration in a race-notice system. If there is a conflict between two persons claiming concurrent interests in the same land, both pursuant to a contract entered into with the same seller, the valid conveyance will be the one that is recorded first.

But this principle can be invoked only if the second purchaser in time who registered first acts in good faith, and has no notice of the first sale, at the time in which he concluded the second sale. If he had actual or inquiry notice, then he is acting in bad faith and the first purchaser in time wins even if he did not register.

Mexico: Under Mexican law, rights with respect to real estate interests exist as between the parties upon execution of the agreement creating such rights irrespective of the registration of the transaction in the Public Registry. The registration of rights in the Public Registry makes these rights known to third parties, and thus the rights can then be asserted against such third parties. As the Mexican system is a race-to-register system, the recordation also affects the priority of liens placed on interests in real estate, not dependent on the date of closing.

5. What would be the effect on the interest in real property if

a. it were obtained by means of a forgery or impersonation, or under fraud or duress?

Germany: Unless rebutted, the presumption of regularity under *BGB* § 892 would still obtain with respect to a person relying in good faith on the registration.

Austria: Relying on the trust principle (*Vertrauensgrundsatz*), the same result is obtained in Austria as in Germany.

Czech Republic: Same as in Germany and Austria.

Switzerland: Same as in Germany and Austria.

Brazil: No response.

Québec: In all of the cases under this question (5), if an incomplete, inaccurate, invalid, or false document has been published by the Register, a valid interest in the property may nevertheless be acquired by a party who acts in good faith and has relied on the accuracy of the Register.

Situations of forgery, impersonation, fraud or duress can be separated into two main categories. The *first* possibility is that the seller of the immovable was not the owner at the time of the purported sale. In this case, the contract with the seller never really existed. If the buyer had possession, the contract could be annulled by the buyer or by the real owner. The *second* possibility is that the interest was acquired by duress. In this case, the contract can be annulled by the victim.

Israel: The relationship between the parties to the transaction before registration is governed by the Israeli Law of Contracts. Remedies such as compensation are available to the party who had suffered loss and damage as a result of the transaction if the responsibility of the other party can be proven. It should be noted that the contract cannot be enforced if a party other than the true owner of the property, pretending to be the owner, was the selling party to the contract, since a contractual right may not be enforced against a person or entity that acted in good faith and is not a party to the contract.

When the defect in the transaction is discovered at a later stage, that is, after registration, the interest of the person who has purchased the title in the property will be valid and affords him a possessory right in the property even if the registration in the land registries was defective, provided, however, that the purchaser qualifies as a bona fide purchaser for value. However, if the transaction was performed by a person pretending to be entitled to perform the transaction but in fact having no authority to do so, the purchaser will not be able to rely on his status as a bona fide purchaser for value.

Any person suffering loss or damage after purchasing a property in good faith due to the misrepresentation or fraud of another party and who cannot assert a claim pursuant to the Real Property Law, 1969, may seek damages from a court under the theory of unjust enrichment and/or the Law of Contracts.

Italy: See Articles 1321-1469 of the Italian Civil Code: In the case of forgery of the signature, the document is a nullity. Forgery of a deed is highly unlikely to occur because, before closing, the civil law notary can be sued for damages and is liable because she enjoys the power of *pubblica fede*, i.e., a power delegated from the state to give credit to certain documents. In cases of fraud or impersonation, as well as in cases of duress, the contract is rescindable and damages can be sought.

Venezuela: According to the Civil Code, the purchase and sale agreement is a consensual one, i.e., the mere agreement between the parties is enough for a validly existing and enforceable contract. Circumstances like fraud, duress, and the like, affect the "consent" element of the contract, and, therefore, once such circumstances are proven, the contract would be declared (by a judge) null and void and treated as if it never had existed.

France: The *conservateur* can record anyway. If there is ground for rescission, rescission can be invoked successfully whether or not the contract is recorded. If a judgment results in rescission, the parties are in the same position as if the contract had never been entered into, and the judgment is recorded to give notice of this situation.

Mexico: It is highly unlikely that forgery or impersonation will occur because, in all real estate transactions, the notary must ensure and verify the identity of the parties. However, if this were the case, the transfer would be considered null and void, and the registrations would have to be amended accordingly.

As for a transaction carried out under fraud or duress, it should be noted that a key element to the purchase and sale agreement is consent. In the absence of consent, which would result if duress or fraud were at play, the transaction can be reversed (if deemed null and void) by judicial declaration.

b. a person transferring an interest in real property were incompetent?

Germany: Same as (5)(a) above. The notary has a duty to convince himself of the competence of the person whose contracts he notarizes. If the notary was aware or should have been aware of the incompetence, then he could be held liable. If it were obvious that a minor acted alone, then the registration office could be held liable for damages.

Austria: Same as (5)(a) above.

Czech Republic: Same as in Germany and Austria.

Switzerland: Same as in Germany and Austria.

Brazil: No response.

Québec: Minors (i.e., persons under the age of eighteen) are protected persons (under advisership, tutorship or curatorship) and are considered incapacitated. The adviser, tutor, or curator will act on their behalf. Alternatively, they must apply for the authorization of the court to be able to contract. An act performed alone by an incapacitated person, without the authorization of the court, may be annulled on the application of that person, without needing to prove any damages. In the case of a person of the age of majority under advisership, the act may be annulled only if that person has suffered prejudice. However, such invalid acts may be confirmed upon attaining the age of majority or being released from protective supervision.

Notwithstanding the above limitations, it is clear that minors and persons under protective supervision may validly make an application for the registration of their rights.

Israel: Same as (5)(a) above.

Italy: Pursuant to Article 1425 of the Italian Civil Code, if a party was incompetent, the contract is rescindable. Pursuant to Article 428, if a person, though legally competent, was not capable of understanding the meaning and effects of the transaction (*incapacità di intendere e di volere*) at the time when the transaction was made (e.g., because of intoxication), the contract is rescindable if grave prejudice (*pregiuzio grave*) is caused to the incompetent by reason of the transaction.

Venezuela: In principle, this is the kind of "error" that the registry office tries to detect during the three days of search and study mentioned above. However, if this happens, a similar consequence to the one described in (5)(a) above would take place.

France: Same as (5)(a) above.

Mexico: Same as (5)(a) above. The notary has to be aware of the competence of the person appearing before him at the time the transaction is made. If the notary was aware of the incompetence, he could be held liable.

c. the title document used in the transaction were invalid?

Germany: The German system technically knows no title documents. Only the land registry is of relevance and it is presumed to be valid. If it were obvious that the registration was wrong, then the registration office could be held liable for damages.

Austria: Same as (5)(a) above.

Czech Republic: Same as in Germany and Austria.

Switzerland: Same as in Germany and Austria.

Brazil: No response.

Québec: The consequences of using an invalid title document would depend on the nature of the invalidity. We refer you to the previous responses.

Documents submitted for publication are certified as to the identity of the parties, their quality, and their capacity. The notary or other professional is also expected to attest that the will expressed by the parties is accurately represented in the document.

Israel: See (5)(a) above.

Italy: The contract is a nullity if the signature has been forged. As has been said, a title document is very unlikely to be forged by a party because the civil law notary checks the land registrations as mentioned above.

Venezuela: See (5)(a) above.

France: The *conservateur* can record anyway, except if this invalidity deals with the chain of title and the title does not match with the chain previously registered, in which case it would be necessary to reject the attempted registration.

Mexico: Although the original copy of the "title document" (which is in essence the public deed through which the seller originally secured title) must be presented at closing, and thus one could speculate at that time about the document's having certain irregularities, the investigation at the Public Registry into the chain of title would uncover such irregularities (e.g., errors as to the identity of the owner, the price, description, and the like). If another document were invalid, for example, a power of attorney, then the transaction could be considered null and void.

d. the description of the real property interest were incomplete or inaccurate?

Germany Same as (5)(a), (b), and (c) above. If the registration office made the mistake, then it could be held liable for damages. In addition, the registration office must correct the mistake.

Austria: Same as (5)(a) above. Descriptions of property are given in their entirety in both the written and electronic cadastral map. The cadastral map also includes zoning information.

Czech Republic: Same as in Germany and Austria.

Switzerland: Same as in Germany and Austria.

Brazil: No response.

Québec: Upon presentation of an application for registration, the Registrar verifies that the documents submitted are complete and that they conform to the form prescribed by law. If the application is not admissible or contains inaccuracies or irregularities, the Registrar does not make an entry. Rather, he remits the application to the applicant and informs him of the reasons for refusing registration.

Israel: See previous responses.

Italy: The following is a summary of different circumstances and remedies.

Vendita a misura, Article 1537 of the Italian Civil Code: If the land is measured by a certain unit (e.g., acre, square foot, or square meter) and the price is determined in relation to that agreed-upon unit (e.g., "I sell you my garden, which is 100 square feet, for $10 per square foot"), the buyer has the right to demand an abatement of the price if the actual size is smaller than agreed upon. On the other hand, if the actual size is bigger than agreed upon, the buyer has the duty to supplement the original price.

Vendita a corpo, Article 1538: If the land sale contract described the piece of real estate independent of any specified measure (e.g., "I sell you the garden adjoining my house, which is 100 square feet, for $1,000"), an abatement of the price must be granted by seller, or a supplement must be paid by buyer, only if the size is smaller or bigger, as the case may be, by more than 1/20. Thus, unlike the case of a *vendita a misura,* if the variation (either up or down) is less than 1/20, there is no right to abatement or supplement. However in both cases, if the size of the property exceeds by more than 1/20 the original size agreed upon, the buyer has the option of paying a supplement or walking away from the contract.

Aliud pro alio: This refers to the situation where the seller states, for example, "Don't worry, you can build a house over the land I transfer to you," but in fact there is a zoning ordinance prohibiting any construction. According to well-settled principles recognized by the courts, a sale contract can be rescinded within five years from closing and damages sought if the property is (i) different from that agreed upon, or (ii) lacks the qualities necessary to fulfill its economic purpose. In case the property is flawed, the buyer can either rescind the contract or demand an abatement of the price. The buyer must exercise this right within eight days from discovery and not later than five years from closing.

Lack of promised or essential quality of the property: This refers to the situation where the seller states, for example, "I promise you can grow fruit on the garden I sell you," but in fact the buyer cannot because the soil is unfertile. This situation is similar to *aliud pro alio*, and the remedies are the same, that is, the land sale contract can be rescinded within five years and damages can be sought.

Venezuela: See previous responses above.

France: If this incompleteness or inaccuracy violates the standards established in the *decret du 5 janvier 1955* or does not match with the geographical references of the last entry in the chain of title, the *conservateur* will reject the submission and not record it. If the foregoing standards are complied with but the description is still inaccurate on the merits, the title will be recorded anyway.

Mexico: Upon the filing of a Public Deed, the Registrar verifies not only the form of the transaction but also that the measurements and areas being affected or transferred match those set forth in the Public Registry. If the application contains inaccuracies or irregularities, it is refused registration and the Registrar advises of the reasons for refusing registration.

With respect to legal remedies in the case of incomplete or inaccurate measurements, the buyer has the right to demand an abatement of the purchase price if the actual size is smaller than agreed upon. On the other hand, if the size is bigger than agreed upon, the buyer then has the obligation to supplement the original price. Since these obligations usually have to be judicially enforced, it is customary in cases where the property has irregular measurements to have the property surveyed and the actual measurements ascertained.

6. How is a mistake or defect in a registration cured?

Germany: The land register must be corrected.[7] A claimant may give notice of his or her claim by having that claim (*Widerspruch*) entered in the land registry subject to a required amount of proof. If there is no correction *ex officio*, then it is made following an application by the person who is benefited by the correction and with the approval of the person who is disadvantaged by the correction. Both declarations are legalized. If the person who is disadvantaged does not approve of the correction, then it cannot be made until a final and binding court decision can be substituted for the missing approval.

Austria: All documents should be free of mistakes and notarized before being presented as part of the application for registration. The matter of correcting mistakes is generally left to the injured party who will either sue or, if a technical mistake occurs, appeal the decision to enter a specific interest in land. The judicial officers occasionally check the *Grundbuch* for mistakes and for invalid entries as well.

Czech Republic: Prior to registration, the Cadastral Bureau will check on the documents submitted to it for registration. If they are incomplete or inaccurate, registration will not be made, and the petitioner will be called upon to remedy the mistake. If there is a mistake, the state will be liable because the Cadastral Bureau is a state body.

Switzerland: Although forgery, fraud, duress, or incompetence may exist in Switzerland, the system of public registration in conjunction with notaries usually avoids these problems.

Brazil: Any errors in the Registry will be corrected either by an administrative procedure before the Registry or by a declaratory judgment.

Québec: The manner in which mistakes or defects in the registration are cured depends on their nature and their source. A distinction is made between errors made by the applicant and errors made by the Registrar. In the former case, the applicant must submit another application, requesting the correction of the error. In the latter case, the Registrar can, unilaterally or upon the request of the applicant, proceed to correct the error in the Index. In both cases, the Registrar must specify the date, hour, and minute of the modification.

Any interested party may, by application to the court, request that information in the Index be corrected. It is also possible to cancel a previous registration by having it struck from the Index. This can be done voluntarily by consent of the parties, or by motion to the court. The procedure for cancellation is mainly used for registrations made without right or irregularly, or where the basis of title is null or irregular in form, or where the registered right has been annulled.

Israel: The authority to correct clerical errors in the registries is given to the Registrar or the Supervisor. The Registrar may order the correction of a clerical error when the error appears in the registration itself and not in the documents that have been used for the registration. The Supervisor may also order the correction of a clerical error when the error appears in the documents that have been used for the registration.

The procedure of correcting defects in the registries that are not due to clerical errors varies, depending on whether the defect was found in the Registry of Bills or the Registry of Rights.

Defects in the Registry of Bills: It is not rare to find defects concerning size and boundaries in the Registry of Bills (i.e., concerning lands that did not go through the parcelation procedure), since such registrations have in fact been inherited from the books held in the period of Ottoman rule. Pursuant to the Real Property Law, 1969, a defect in the registration of the size of a parcel or of its boundaries can be cured upon request by the title owner to the Land Supervisor. The Supervisor will issue an order for the correction of the registration after hearing all the interested parties. Such order will be issued sixty days after the publication of the request if no opposition is filed.

Defects in the Registry of Rights: A registration in the Registry of Rights is conclusive evidence of its contents. However, in some specific cases provided for by law, details of the registration can be changed. If a defect in the registration concerning a right in the property was the result of a fraud, the District Court has the authority to correct the defect, provided that the property was not purchased by a third party in good faith and for consideration from the registered owner of the property, in which case the registration will remain as it is. If it is proven that a mistake was made in the measurement of a property, details of the registration concerning the size of the property may also be corrected by the Registrar or by the District Court. Any defects not specially dealt with in this paragraph can be cured only pursuant to a court order, regardless of the nature of the defect or the kind of registry.

Italy: A mistake is corrected by rectification performed by the civil law notary. Consent of both parties is needed.

Venezuela: See previous responses above.

France: If there is a mistake in a contract previously registered, the *Notaire* can draft a corrective deed and have it recorded himself without the intervention of the parties, if this corrective deed is within the scope of his agency provided for in the original contract. The registration system may not contain a mistake in the chain of title caused by a *Notaire*.

Mexico: Generally, an error made by the applicant results in the Registrar's refusal to effect the registration. An error that nonetheless finds its way into the registry can be corrected by the notary's filing of a note. An error made by the Registrar can be corrected by the Registrar unilaterally or upon request of the interested party.

7. Who pays for curing the mistake or defect in a registration?

Germany: Normally the person seeking the correction pays for it in the first instance. If, however, the mistake is the result of an intentional or negligent act (e.g., wrong documents or inaccurate statements), then the person who presented the incorrect information bears the costs.[8] If a defect is the fault of the state, then the state will be liable for damages.

Austria: The injured party must file a suit for the deletion of the mistake or defect within sixty days after the mistake or invalid entry was registered. The losing party pays for any costs associated with curing the mistake since Austrian civil litigation provides the winning party with a cost award. If the mistake was made by a court officer, the state may be liable for the reasonable costs incurred by the petitioner in the rectification proceedings.

Czech Republic: The state.

Switzerland: The state covers possible damages for mistake. In addition, private notaries must have professional insurance to cover any possible liability.

Brazil: It is very unlikely that one would hold the government liable for any mistakes. As a guard against mistakes, the notary must read the record aloud in the presence of the parties to make sure that it does not contain any mistakes.

Québec: The applicant must pay the application fee for the correction if he is the source of the mistake. Understandably, he is not responsible for costs where the Registrar has committed the error. In the case of a request for cancellation, court costs and lawyer fees may be payable in addition to the application fee. The party who is applying for the cancellation must pay all necessary costs.

Israel: The cost of correcting a defect in the registries is borne by the entity requesting the correction, unless otherwise ordered by the court.

Italy: The party or the notary should pay, depending on who made the mistake. In fact, parties generally reach a friendly agreement at the time since the fee of a civil notary for rectification is not too expensive, normally around $500.

Venezuela: No response.

France: The buyer is supposed to pay all expenses of the contract; the cost of a corrective deed is very low.

Mexico: The applicant must pay any fee in connection with the corrections if he is the source of the mistake in the registration. If the Registrar has committed an error, then the processing fees are waived.

8. How long does it take to cure the mistake or defect in a registration?

Germany: A few months to many years, depending upon the agreement and cooperation of the necessary parties. If a preliminary injunction is used, then it will usually be decided within three-to-ten days.

Austria: Once litigation is concluded, the entry is immediately amended. During the course of a litigation, a controversy note should be attached to the property sheet in the registration office. An appeal to an appellate court takes about one-and-a-half years; an appeal to the Supreme Court of Austria takes three-to-four years.

Czech Republic: There are many delays and difficulties.

Switzerland: It is impossible to give a general estimate of the time frame within which a mistake would be cured.

Brazil: No response.

Québec: The time period for correcting an error varies greatly from one registration division to the next. The application for rectification is subject to the same delay as any new application for registration. However, under a fully computerized system, the mistake will be cured the same day as it is received, within a targeted delay of four hours.

If the Registrar is the source of the error, the correction will be dealt with only after new applications have been processed. The delay will vary according to the volume of applications for registration.

Requests for cancellation are treated with the lowest priority.

Israel: The time involved in the curing of the defect varies depending upon the procedure. A court procedure may take several years, whereas an application to the Registrar for the correction of a clerical error usually entails only a few months.

Italy: It is immediately cured upon filing the rectification in the *Ufficio del Territorio* where the real property is located.

Venezuela: No response.

France: Between one week and one month.

Mexico: As the Public Registry system is inherently local, the period of time it takes to correct an error varies greatly from office to office. However, the application is generally given the same treatment as a new application and is dependent only on the work volume of the particular office.

9. Who pays the holder of the real estate interest for loss or damage incurred by that holder because of the mistake or defect in a registration?

Germany: The person who is at fault. The German notary is required to carry mandatory professional liability insurance.

Austria: The person who is at fault. The losing party pays restitution damages. In addition, the state has liability for mistakes by judicial officers.

Czech Republic: The state.

Switzerland: The state covers possible damages for mistakes. In addition, private notaries must have professional insurance to cover any possible liability.

Brazil: No response.

Québec: The general principles of civil liability apply. The person who is responsible for the mistake or defect will be responsible for compensating the holder of the interest for any loss incurred. If the applicant is the source of the error, he will be held liable for damages.

If the prejudice results from the negligence or fault of the Registrar, it is the state that will bear the ultimate responsibility. This is the case even if the Registrar was acting illegally or outside the scope of his authority. However, because of the scope of the Registrar's responsibility, he will usually only be held liable for mistakes resulting from the negligent technical verification of the information submitted. A further provision in the law expressly excludes the liability of the Registrar where the damages result from the error or negligence of another.

Notaries and lawyers have statutory insurance covering their civil liability. If they are the source of the mistake or defect, their professional insurance will compensate for any damages suffered by the buyer or third parties.

If a title insurance policy exists, the title insurer will compensate for damages up to the amount covered by the policy. In this case, no proof of fault or negligence is needed; the only requirement is proof of damages suffered.

Israel: If a defect in registration cannot be corrected, and the defect was caused by means of fraud, any entity that has suffered losses or damages due to the defect may apply for a court order to obtain compensation from the entity responsible for the fraud. The state and its institutions cannot be held responsible for a defect in registration due to an act or omission made in good faith.

If the defect has been successfully corrected, the entity that had borne the costs of the correction may apply for a court order to obtain reimbursement and compensation from the party responsible for the error. Compensation is usually based on the market value of the property and is calculated in light of the material losses incurred by the title owner.

Italy: The occurrence of a mistake or a defect in the registration system is not common in Italy because, before closing, the civil law notary has the duty to assess, verify, and check the validity and correctness of the deed kept by the *Ufficio del Territorio*. If there is a mistake, she has the duty to rectify it. The conclusion is that the civil law notary in charge of the transaction would be liable if the mistake relates to the real estate.

Venezuela: Theoretically speaking, there could be a suit against the party responsible for the mistake, e.g., the other party to the purchase and sale contract and/or the registry office. The losing party would have to pay for such damage or loss. However, such lawsuits occur very infrequently in Venezuela.

France: The *Notaire* is liable if the holder required him to register and the *Notaire* did not register. He will have to compensate for all the loss. The *Notaire* is covered by insurance, and all the *Notaires* are jointly and severally liable. The *Notaire* is liable toward his client for all defects contained in the title he drafts if the defects cause harm to his client. If the *Notaire* informs a client of the existence of such a defect, and the client nonetheless seeks to go forward, the *Notaire,* to avoid liability, must obtain a letter from the client acknowledging this situation.

Mexico: The general principles of civil liability apply in this case. The individual responsible for the mistake or defect will be responsible for compensating any loss. If the notary is responsible for the error, then the notary will be subject to liability. If the error was made by the Registrar, then ultimate responsibility resides with him. However, this will only be the case if the mistake resulted from negligent technical verification of the information submitted.

10. Does the land registration system indicate the value of the real property interest?

a. Does it indicate the amount paid for the interest, the amount secured by that interest (as in a loan), or the present value of the interest?

Germany: No, in the normal case. In an exceptional case, if, for example, it were evident that the price was way out of line, and that the contract was therefore of doubtful validity, the registration office could refuse to effect the entry.

Austria: It is currently under debate whether nonlegal information, such as information used for economic appraisal, should be allowed to be entered. However, the cadastral may indicate economic value or the purchase price.

Czech Republic: No response.

Switzerland: No.

Brazil: No.

Québec: The amount paid for the interest or the amount secured by the interest is indicated in the Index of Immovables. However, the present value of the interest is not indicated.

Israel: No. The registries do not indicate the economic value of a real property interest. The value of any property transaction will be influenced by general economic forces. The economic value is usually established before each transaction by a land assessor. The services of a land assessor will also be used in court or arbitration procedures if necessary.

Italy: No. Only the registration of a mortgage must indicate the amount of consideration paid. In the contract (which is never registered), the purchase price (not the value) is indicated.

Venezuela: Since the amount of the transaction serves as the basis for calculating the registration fee, the parties, in their purchase and sale agreement, tend to reflect a lower amount than the one actually transacted between them. For this reason, the registry office has a list of estimated prices per square meter of real estate according to their location in the jurisdiction. When the registry office does not agree with the price that the parties have reflected in their document, the registry office (only for the purposes of calculating the registration fee) sets a new price per square meter according to the market price of the real estate. Consequently, we can affirm that the registration of real estate reflects the market price of interests.

France: The registration system indicates the price of the interest mentioned in the contract or title that is recorded, as well as the amount of any loan secured by the interest (together with the amount that is secured to cover court costs, if necessary). The date of the extinction of the security interest is also mentioned (i.e., the date of the last installment plus two years).

Mexico: The Public Registry denotes the amounts paid and amount secured but not the present value of the interest.

b. When an interest in real property is registered, is any value shown at full or market value or at some lesser amount?

Germany: No. The purchase price, which is properly a matter between the parties only, is not shown in the registration office. Even though the land register is a public document, the information contained in it is available only to state authorities and to private persons who have a legitimate interest in it. The restrictions against looking behind the registration are even greater with respect to the documents underlying the registration, e.g., the sale contract, which would show the purchase price.

Amounts of mortgages and land charges, however, are shown but they are not to be taken at face value. It should be noted that (i) a land charge (*Grundschuld*) may or may not represent actual debt since a land charge may be registered without securing any debt, and, even though it once represented debt, it might not have been cancelled when the debt was repaid (this facilitates reuse of the land charge at a lower expense); (ii) banks look for security in addition to land and therefore tend to lower their valuation of land used as security; and (iii) the sum of all mortgages and land charges is usually, but not always, less than the value of the real property.

Austria: The commercial value of a parcel is not shown in the registry because of the impossibility of regularly updating information regarding the value of land. The registry will, however, show the interest payable on mortgages since lending institutions need to know not only the principal but also the interest secured by a certain lien. The principal secured by a mortgage will generally equal sixty percent of the commercial value of the property. This indicator of value does not exist where there are no mortgages.

Czech Republic: No response.

Switzerland: The purchase price is not publicly available. The amount of the mortgage and interest thereon are shown in the registry.

Brazil: A nominal amount.

Québec: The value shown on the inscription on the Index of Immovables is the value actually paid to acquire title. This practice is dictated by municipal taxation laws, which tax transfers of immovables according to the greatest of the actual amount paid, the value paid as set forth in the transfer document, and the market value at the time of the transfer.

Israel: See previous response above.

Italy: In the case of a mortgage the full value amount of the mortgage is registered. In all other cases, the value is not registered.

Venezuela: See previous response above.

France: For a sale, the amount indicated in the registration system is the price mentioned in the contract. Usually, but not always (e.g., for tax reasons), the price reflects the market value. If the price cannot seriously be claimed to be equal to the market value, the market value of the interest must be mentioned, but only for tax purposes.

With respect to gifts and inheritances, the interests are transferred without value, but the transfer of title must still be registered and the market value of the interests subject to the transfer must be mentioned. This value will be a basis for various taxes and the *conservateur's* compensation of 0.01%.

Mexico: The law requires that the full market value be shown at the time the transaction is carried out in order to calculate certain property taxes, including a transfer tax.

c. If loss or damage is sustained by an injured party because of a defect in a registration, is the party compensated at a value based on full or market value or at some lesser amount?

Germany: The measure of damages is the value of what a person has spent and what that person has lost, valued at the time of the loss. Normally an appraiser (who must be a court-certified expert) is engaged to establish the market value at the time of the loss.

Austria: The injured party will be compensated "at value," but, because of strict liability rules, the burden of proof is substantial. The losing party pays the cost of the litigation.

Czech Republic: The injured party is compensated according to the data contained in the sales contract, basically at market value.

Switzerland: No response.

Brazil: No response

Québec: General principles of civil liability apply. The injured party would be compensated for any loss or damage directly caused by the defect in the registration so long as the amount of damages can be proved.

Israel: See previous responses above.

Italy: The civil law notary will be liable for damages assessed by a court, considering not only the amount actually paid but also *lucrum cessans* (lost profits due to an illegal act) and *damnum emergens* (actual damages).

NOTE: In the preparation of these responses to the questionnaire, three civil law notaries who work in Rome were interviewed, and all of them agreed that there is no need for obtaining title insurance in Italy. The title search conducted by notaries, their liability for damages, and a well-engineered and expensive land registration system suffice. Two possible exceptions to this general statement exist, as follows:

(i) The acquisition of real property from a commercial entity might constitute an exception because every commercial entity is subject to the Italian Bankruptcy Act, *Reggio Decreto 16 May 1942, n. 267*. This (absurd) legislation provides that any transfer made within two years prior to the date of filing for bankruptcy can be revoked by the bankrupt's estate; and

(ii) Donations of real estate made by the decedent during his lifetime may, according to Article 560 of the Italian Civil Code, be reduced by the survivors if they have been illegally affected by the transfer. The decedent's issue are entitled to thirty percent of the estate and, if this percentage has been reduced, the issue can invalidate the donations of real estate, commencing with the most recent one.

Venezuela: See the previous response above.

France: It should be the value bargained for by the injured party unless there is a significant change in the circumstances at the time when the claim is asserted.

Mexico: Again, the general principles of civil liability apply. Compensation would be made for any loss or damage that can be proved in court.

Endnotes

1. Sections 873-1203 of the *Bürgerliches Gesetzbuch* (*BGB*).
2. Section 867 of the *Zivilprocessordnung*. In addition, the Title Registry Code (*Grundbuchordnung*) is important.
3. In the case of the State of Baden-Württemberg, the office is maintained in the office of the local notaries' office. The procedural rules are regulated in the German Land Register Code (*Grundbuchordnung*).
4. *See, e.g.*, Sections 297a, 431-446, 451, 453 etc. thereof.
5. *Grundbuchsgesetz* and the *Grundbuchsumstellungsgesetz*.
6. Pursuant to Section 892 of the German Civil Code, there is a rebuttable presumption that the right exists (and that any right not registered does not exist).
7. *BGB* §§ 894-898.
8. *BGB* § 897.

APPENDIX 2

Foreign Respondents to the Questionnaire

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Venezuela:	Patricia Rodriguez E-mail: patriciarodri24@hotmail.com
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Mexico:	Manuel Campos-Galvin

Endnote

1. 2002 Research Assistant to Prof. Dr. Peter Bvdlinski, Karl-Franzens-Universität, Graz, Austria.

Appendix 3

International Title Insurance Contacts

First American
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Vice-President, General Counsel—Canada
1290 Central Parkway West, Suite 801
Mississaugua, Ontario, Canada
Tel.: (877) 768-3111
www.firstcanadiantitle.com

David Turschwell, Solicitor
First American Title Insurance Company (UK) plc
Walkden House
3-10 Melton Street
London NW1 2EB
England
Tel.: 011 44 20 7209 9900
Fax: 011 44 20 7209 3354

LTIC
LandAmerica Financial Group, Inc. (LandAmerica),[1] through its subsidiary,
Lawyers Title Insurance Corp. (LTIC), by its exclusive agent,
International Title Corp. (ITC), a subsidiary of
Greenberg, Traurig, P.A., an international law firm

F. Linton Sloan, Jr., Senior Vice President
Lawyers Title Insurance Corp. (LTIC)
201 South Orange Avenue, Suite 1350
Orlando, Florida 32801
Tel.: (407) 481-8181
Fax: (407) 481-2360
E-mail: Isloan@landam.com

Stewart Title
For copies of Stewart Title's policies, see Stewart Title at www.reprofile.com, "Virtual Underwriter Forms."

Endnote

1. According to its Web site, LandAmerica Financial Group is one of the top title insurance companies (with First American and Chicago Title) in the United States. The company owns Lawyers Title Insurance, Commonwealth Land Title Insurance, and Transnation Title Insurance. In LandAmerica's eyes, its top competitors are Fidelity National, First American Corporation, and Old Republic.

APPENDIX 4

Where International Title Insurance Is Offered

1. *First American*—Twenty-seven countries, including the United Kingdom, Ireland,* Italy, Germany, France, Spain, South Korea,* Singapore, Japan, Hong Kong,[1] the Caribbean (i.e., Antigua, Aruba, Bahamas, Barbados, British Virgin Islands, Dominican Republic, Jamaica, Puerto Rico,* St. Lucia, Trinidad & Tobago, Turks & Caicos Island, U.S. Virgin Islands*), Mexico, Australia* and Canada.* Countries marked with an asterisk have Direct Operations.

   As of October 1999, "Possible Countries" include Argentina, Brazil, Chile, Venezuela, Poland, Hungary, and the Czech Republic. "Doubtful Countries" include Romania, Latvia, Thailand, Taiwan, and India. Countries marked "No" are Russia, China, Middle East (e.g., Syria, Jordan, etc.), and the Philippines.

   In its brochure, First American states that it offers standardized, comprehensive owner's and lender's policies that can be used in many nations. These are uniform policies that obviate the need for determining where coverage differences occur from country to country.

2. *LTIC*—South America, Central America (except El Salvador), Mexico and all countries and territories located in the region known as the Caribbean Basin (except Cuba and Haiti), plus Bermuda. On February 8, 2001, it announced that it had agreed to enter into a joint venture agreement with Avalon Holdings, Ltd. and Shield International to provide title insurance and real estate-related products and services in Israel.

3. *Stewart Title*—Stewart Title has a new product, not yet available on its Web site, called Global Advantage Title (GAT).™ It will be furnished to any serious customer subject to a confidentiality agreement. Its main feature is the fact that it contains eighteen additional insuring provisions.[2]

   According to its Web site, the following are the countries in which Stewart offers coverage:

   Guam, Saipan, Belize (reinsurance), Mexico, U.K., Canada, and Puerto Rico. There are no forms available for the Bahamas or Virgin Islands. In Puerto Rico, the company also offers Leasehold Owner's and Leasehold Loan Policies. Although Stewart's Web site states that it provides insurance in Costa Rica and the Dominican Republic, those forms are not available at www.reprofile.com, "Virtual Underwriter Forms."

   Stewart's International Group is installing real estate information systems in Hungary, Slovakia, Moldova and the Republic of Georgia. Stewart is also a partner in a mortgage insurance company in Israel through which it offers private mortgage insurance. The Stewart Title Corporate Web Site Investor Section also offers a number of articles on real estate in Mexico. Title work in other countries is considered on a case-by-case basis.

4. Chicago Title Insurance Company—No information was available.

Endnotes

1. First American was licensed in 2001 by the Hong Kong Insurance Authority to issue title insurance policies on all Hong Kong properties. It also formed a joint venture company, First Hong Kong Title Limited, with local investors to provide related services.
2. From notes hastily made during a telephone conversation, they include unmarketability; communal, aboriginal, indigenous (for Australia), and *ejidos* land ownership; lack of access; forgery and impersonation; fraud and duress; incompetency; invalid title documents; inaccurate or incomplete property description; encumbrances; matters having to do with judgments imposed by a court of competent jurisdiction against the named insured that violate existing insurance laws; restrictive covenants; and servitudes.

APPENDIX 5

Cost of International Title Insurance Policies

1. First American

a. The Company uses its own rate schedule, with $3.00 to $4.00 per thousand being average. There is a minimum premium of $5,000 and a $10,000 deposit.

b. In the UK, the premium is £3.50 per £1,000 of indemnity including reinsurance.

2. LTIC

a. Premium, depending upon location, from $2.00 to $6.00 per thousand, with a *minimum* premium of $50,000.

b. Non-refundable "search and exam fee" to be determined by LTIC and ITC after review of the application for title insurance.

c. Fee. At the time of the issuance of the commitment, there is a commitment fee payable. Although nonrefundable, the commitment fee is credited against the total premium due. This suggests that an insured may obtain only a commitment without also procuring a policy.

3. Stewart Title—for Mexico

a. The application fee ranges from $500 to $3,000 (if a title search or title update from scratch is required). If the property is a "one off" search, that is, a search involving property for which Stewart has never done title work, the application fee is $3,000. On properties where Stewart already has a base file, the title update fee is $500. The application fee will vary, depending upon the location of the property, but Stewart undertakes to use its best efforts to obtain the lowest fee possible for the benefit of the customer.[1]

b. Generally speaking, the one-time premium payment for residential properties is calculated at $7 per $1,000 of the purchase price, not the declared value of the operation. In the case of land transactions, the premium is fully negotiable, based upon the aggregate insured value, i.e., coverage for both land and improvements. The general range for premiums is between $4 and $7 per $1,000 of insurance coverage.[2]

4. Chicago Title Insurance Company—No information was available at press time.

Endnotes

1. See Mitch Creekmore, Vice President & Development of Mexico Business Development, *Process Flow, Commitments, Fees & Premiums of Stewart Title Guaranty Company*, available on the Stewart Title Web site.

2. *Id.*

Appendix 6

Title Insurance Coverages in the United Kingdom

1. Stewart Title's policy is called a "Conveyancing Indemnity Policy" and, as indicated above, the underwriter is Stewart Title Insurance Company (UK) Limited.

2. In addition to the familiar coverages, this policy includes the following:[1]

   - Lack of capacity or other disability of any predecessor in title from any cause (including but not limited to that arising from bankruptcy or insolvency proceedings);

   - Covenants adversely affecting or restricting the current use and enjoyment of the Property at the Policy Date;

   - Lack of access to and egress from the Property (including those relating to provision of the utilities set out in Schedule B);

   - Any inaccuracy or omission in the replies to the usual form of search and enquiries (including Additional Enquiries where appropriate) to a local authority or other body (including but not limited to mining or commons registration searches) of whom searches and enquiries are usually made, or changes therein prior to the Policy Date whether such replies are obtained by personal search or otherwise;

   - Lack of necessary planning permission and/or building regulation approval relating to the use of the Property at the Policy Date;

   - "Overriding Interests" in the event that the Property is registered land as defined in section 70(1) Land Registration Act 1925 or other similar rights affecting or applicable to unregistered land;

   - Any of the foregoing defects affecting a superior estate upon which the insured leasehold interest depends; inconsistency of the Insured Leasehold with any superior estate; forfeiture of the Insured Leasehold by reason of the non-performance (including non-payment of rent), of any obligation imposed by the superior Leasehold Interest which had matured and was due to be performed or paid prior to the Policy Date, but not otherwise;

   - Failure of a Company approved solicitor or licensed conveyancer to perform the Standing Instructions relating to the loan, mortgage or completion in all material respects; and

   - The contents of the report on title submitted by a Company approved solicitor or licensed conveyancer in respect of the Property not being true and accurate in all material respects.

Endnote

1. Contrast these inclusions with the Exclusions from Coverage contained in the standard ALTA Policy.

Products Liability Prevention: What Every International Business Should Know About Selling Products in the United States

By John F. Zulack and Jennifer K. King

I. Introduction

Virtually all foreign businesses selling or considering selling products in the United States have a common concern about their exposure to products liability lawsuits in U.S. courts. Such concern is understandable, given the highly publicized U.S. jury awards for punitive damages totaling hundreds of millions of dollars.

Thus, the most frequently asked question among foreign corporations is how they can *eliminate* their legal liability for products sold in the United States. The simple yet blunt answer is that no business, whether foreign or domestic, can completely eliminate the risk of a products liability claim. Moreover, a foreign company which manufactures products that it knows will regularly be imported into and sold in the United States can be sued in a U.S. court action, even if the foreign manufacturing company has no office or business entity in the U.S. and does not itself sell directly in the U.S. Nevertheless, with the proper guidance and commitment, corporations can reduce the likelihood of being sued and if sued, increase their ability to defend successfully a products liability claim by proactively adopting a risk management program.

A successful risk management program essentially consists of three components: procuring appropriate products liability insurance; anticipating legal strategies to defend products liability claims; and implementing preventative measures directly related to the product itself. This article first addresses issues specifically related to the procurement of products liability insurance that every manufacturer should consider. Secondly, this article considers how manufacturers can pro-actively create and maintain records to be used to defend against a future products liability claim. Finally, this article describes how manufacturers can design a program of preventative measures to reduce and detect problems during the design, production, distribution and sales phases of each product.

To achieve the ultimate goal of minimizing products liability claims, manufacturers must be willing to adopt a systematic approach to products liability. To do so requires a strong corporate commitment to obtaining the most appropriate products liability insurance, designing the most effective document retention policy, and implementing procedures to enhance product safety.

II. Products Liability Insurance

The two main considerations for manufacturers with respect to products liability insurance are the policy's coverage and the premium costs. At a minimum, manufacturers must ensure that their products liability policy provides sufficient coverage and contains those components that are most beneficial to manufacturers. Some often neglected yet vitally important issues concerning products liability insurance include restrictions on coverage, liability assumed in contracts with suppliers and purchasers, the identity of those insured, the defense of legal claims and successor liability. Given the complex and policy-specific considerations, it is advisable that manufacturers seek independent advice as to the sufficiency of their existing products liability insurance policy and the necessity for additional coverage. For example, if sales of goods in the U.S. are to be governed by a group-wide policy purchased from a foreign carrier, one must be assured that claims in North America are not excluded by the terms of the policy.

Despite the high costs of products liability insurance, manufacturers should resist any temptation to undermine their insurance coverage. Rather, manufacturers should thoroughly research products liability insurance products and explore methods to reduce premiums while maintaining sufficient coverage. The ability of a group (and not just the U.S. subsidiary of such a group) to bear a high deductible to reduce the premium should be considered, especially if it is likely that a manufacturing parent will be sued along with the distributing U.S. subsidiary. Or, for example, a manufacturer may be able to reduce insurance premiums by demonstrating to its insurance carrier how its risk management program enhances product safety and reduces the likelihood of products liability claims.

III. Legal Strategies to Defend Products Liability Claims

Despite the strict liability standard applied in products liability claims, it is vital not to underestimate the importance of properly maintained and accessible documents. Documents will play a crucial role in any successfully defended products liability claim. For example, a manufacturer's documents can be used to rebut a plaintiff's allegations of wrongdoing so as to defeat or minimize claims for punitive damages. In addition,

documents can be used to assert that the product either did not cause plaintiff's injuries or that the product did not contain a defect. Lastly, documents are vital to impeach the plaintiff's credibility. Thus it is essential that foreign businesses develop and implement a corporate policy of documenting information during every phase of a product's life cycle.

Keep in mind that in the discovery phase of U.S. litigation, plaintiffs have the right to require a defendant to produce documents from the defendant's own files. Nevertheless, although creating and maintaining documents presents the risk that a products-liability plaintiff will obtain access to such documents during the discovery phase of litigation, this risk must be weighed against the losses a manufacturer will likely sustain without the ability to present documentary evidence in its defense.

IV. Products Liability Awareness Program

Simply stated, the most effective way for businesses to minimize products liability claims is to incorporate risk management strategies into every phase of a product's life cycle. Given the importance of developing such strategies, it would be beneficial for businesses to create an internal committee whose function is to develop and supervise the implementation of safety standards and review operations related to safety.

A. Products Liability Awareness Committee

1. Purpose of Committee

A "Products Liability Awareness Committee" affords businesses two distinct opportunities. First, the committee can draw from the experience and expertise of various departments within the company to review existing and proposed design safety-related procedures. Additionally, in the event of future products liability claims, the committee's proactive involvement demonstrates the corporation's responsibility and overall commitment to product safety.

2. Committee Composition

The Chairman of the Committee should be a Director or senior-level manager, preferably with a strong commitment to safety issues, who has the authority to adopt and implement risk management strategies. Members of the Committee should be drawn from all key departments in order to promote a diversity of perspectives and expertise and to facilitate the dissemination of information at the department level by committee members. If the manufacturing activity of the group takes place in a foreign affiliate, then the committee may well need to be established there, but with input from the U.S. operations as to the specific legal requirements and issues in the U.S.

3. Review and Adoption of Safety Standards

Quite often, product safety standards are mandated by government regulatory agencies. At the very least the Committee must ensure that the company's products meet all applicable statutory and regulatory safety standards. The Committee should be mindful, however, that compliance with government and regulatory standards will not insulate the company from products liability claims. Therefore the Committee should independently evaluate whether required safety standards are sufficient and strive to exceed safety standards whenever economically feasible.

4. Document Retention

As discussed above, documents are a vital component of any successful products liability defense. The Committee can serve an important function by centralizing and organizing the various documents that are beneficial to defending a products liability claim. In its document management capacity, the Committee will also be able to review and update these documents. The Committee needs to regulate the degree to which "advocacy" memo writing is allowed to take place in regard to its activities. Since such files may be subject to discovery in later product liability litigation, if a particular design, materials, warning, or packaging alteration is mentioned in the documentation and is later rejected, the documentation should include a rational and defensible explanation of why the alternative was rejected.

B. Product Development and Design

1. Committee Action

The Products Liability Awareness Committee should be involved in every aspect of new product development. Prior to initiating the design phase, the Committee should review the product concept to evaluate whether the proposed product can be made safe. Among the issues the Committee should address during its threshold safety inquiry are the proposed product's utility, all possible uses and misuses of the product, and alternative products that serve the same purpose. Evaluating the ability to make a product safe is relevant because U.S. courts have found liability for manufacturers' initial decisions to produce a particular product. In other words, a manufacturer should not pursue product design or development unless and until the Committee determines that the product serves a useful purpose and no alternative concepts offer greater safety.

Once a product concept is approved, the Committee should remain active during the phase of product design. The Committee should be responsible for evaluating different design proposals and ultimately selecting the best design based on safety criteria. During its

design-phase analysis, the Committee should consider which materials are required for production, alternative materials and the suppliers of such materials. With respect to component parts, the Committee should evaluate suppliers, component part placement in and interaction with the finished product and the effect of future component part failure on the product. The Committee should also evaluate the need for safety devices and consider several alternative solutions, given that the issue of safety devices is frequently the subject of litigation. During its evaluation of safety devices, the Committee should consider the safety of non-users to ensure that safety devices are sufficient to protect third parties from harm. With regard to the end-use of the product, the Committee should further analyze the effect of possible malfunction or intervening forces on the product itself.

2. Documents to Be Retained: Product Development and Design

- *Final Selection of Product Design*: records describing how and why final product design was approved for production and detailing how benefits of chosen design outweigh the risks of danger.
- *Alternative Designs*: records describing alternative designs considered and reasons why they were rejected. (See Part IV.A.4. above.)
- *Compliance with Statutory and Regulatory Standards*: records establishing that product design meets all existing statutory and regulatory safety standards.
- *Prototype Testing*: documents describing the tests conducted, by whom and the evaluation of the test results.
- *Future Design Changes*: records discussing how and why design is changed to comply with "state of the art" design and manufacturing standards.
- *Alternative Materials and Component Parts*: records indicating alternative materials and component parts that were considered in designing the product and the reasons why they were not selected. (See Part IV.A.4 above.)
- *Engineering Records.*

C. Quality Control, Inspection and Testing of Component Parts, Materials and Finished Products

1. Committee Action

Prior to procuring component parts and materials, the Products Liability Awareness Committee should establish specifications for all parts and materials. The Committee must then establish a testing and inspection program to ensure that the component parts and materials meet the company's specifications. The frequency and intensity of inspections and testing will naturally depend upon how essential the component part or material is to the product's functioning and the likelihood that its malfunction would cause serious injury. The spectrum of possible initiatives ranges from visually inspecting all component parts and materials to testing randomly selected component parts and materials.

With respect to testing finished products, the Committee must ensure that the testing standards comply with any applicable statutory or regulatory testing requirements. Yet the Committee should explore the need for additional testing procedures, given the fact that compliance with statutory and regulatory standards does not absolve a manufacturer from liability. Again the spectrum of procedures ranges from testing some randomly selected finished products to testing every finished product. Undoubtedly the Committee's development of its finished product testing procedure will weigh the costs against the safety benefits derived from each testing alternative.

2. Documents to Be Retained: Quality Control, Inspection and Testing of Component Parts, Materials and Finished Products

- *Purchasing Records*: documents indicating the name of every supplier, the date of purchase and delivery and the quantities supplied for all component parts and materials.
- *Production Records*: documents detailing manufacturing procedures, processes and actual production.
- *Quality Control Procedures*: manuals and other documents describing quality control procedures and all specifications for component parts, materials and finished products.
- *Tolerance for Deviations*: records describing tolerance for deviations in production processes, component parts, materials and finished products.
- *Product Acceptance and Rejection*: records of finished product acceptance and rejection throughout the history of production.

D. Product Warnings and Instructions

1. Committee Action

When creating and reviewing product warnings and instructions, the Products Liability Awareness Committee must take into consideration all foreseeable users and uses of the product. Although a discussion of all issues relating to product warnings and instructions is beyond the scope of this article, the Committee should pay particular attention to children and non-English speaking users to determine the need for sym-

bols in addition to written words. Ultimately, the Committee should strive to make all warnings and instructions as clear and detailed as possible.

The Committee must also be mindful that the warnings and instructions fully comply with existing statutory and regulatory requirements. The Committee should also consider whether these statutory and regulatory requirements are sufficient, or whether including additional information would enhance the safe use of the product or limit the liability caused by misuse.

2. Documents to Be Retained: Product Warnings and Instructions

- *Final Determination of Warnings and Instructions*: documents describing how and why warnings and instructions were selected.
- *Alternatives Considered*: records describing alternative warnings and instructions considered and reasons why they were rejected. (See Part IV.A.4 above.)
- *Changes to Warnings and Instructions*: records documenting the Committee's review of warnings and instructions and modifications made to enhance their effectiveness.

E. Packaging

1. Committee Action

During the selection and periodic review of product packaging, the Committee should confirm that the packaging complies with government regulations. As always, the Committee should be encouraged to adopt more stringent packaging standards to the extent that they would enhance product safety.

2. Documents to Be Retained: Packaging

- *Compliance with Statutory and Regulatory Standards*: records indicating that product packaging complies with current statutory and regulatory requirements.
- *Selection of Packaging*: documents explaining the rationale for selecting certain packaging design and materials and describing other designs and materials considered and the reasons for their rejection. (See Part IV.A.4 above.)
- *Packaging Changes*: records illustrating periodic review of packaging and reasons for any changes in packaging design or materials.

F. Distribution, Shipping and Storage

1. Committee Action

The Committee's primary goal with respect to product distribution is to develop an awareness of foreseeable alterations to the product. Although a manufacturer is not normally liable for defects that arise after the product has left its control, liability can exist if alterations were foreseeable and ignored by the manufacturer. Therefore it is imperative that the Committee establish a method of investigating alterations and modifications made to the product at the hands of wholesalers, retailers and consumers. To this end, the Committee should employ the sales and service personnel to report any product alterations and misuse they observe. Once product alterations are discovered, the Committee should then evaluate the safety risks presented by each alteration and explore solutions to minimize such alterations.

It is also important for manufacturers to recognize that they cannot eliminate liability by delegating duties to others in the chain of distribution. To the extent that a manufacturer delegates product assembly and inspection to retailers, the Committee must establish standards and training for assembly and inspection by retailers. Similarly, the Committee must develop procedures by which the manufacturer can review retailers' compliance with the manufacturer's assembly and inspection standards.

2. Documents to Be Retained: Distribution, Shipping and Storage

- *Standards and Subsequent Modifications*: documents describing various shipping and storage requirements.
- *Retailers' Compliance with Manufacturer's Standards*: records indicating the procedures by which the manufacturer evaluates retailers' compliance with standards.

G. Sales and Advertising

1. Committee Action

The most critical role of the Products Liability Awareness Committee with regard to product sales and advertising is to ensure that false or misleading claims are not made about the product. In particular, the Committee should carefully review all advertised claims made with respect to product safety to ensure that users perceive any real dangers associated with the product and its uses. Indeed, the Committee should recognize that any claim or information conveyed by sales, advertising, or packaging copy, including even photographs showing a particular use of or way to handle the product, may be viewed by courts as an express warranty or representation in regard to the product or its use. In addition, the Committee may consider developing a training program to educate sales personnel how to communicate properly and effectively warnings to customers.

2. Documents to Be Retained: Sales and Advertising

- *Sales Brochures and Other Promotional Materials*
- *Instruction Manuals*
- *Advertisements:* copies and recordings of advertisements, indicating date and method of publication
- *Other Documents:* Any other documents relating to the introduction of the product into the U.S. marketplace.

H. Product Complaints and Customer Service

1. Committee Action

The Committee should strive to design user-friendly methods to obtain customer feedback and product complaints. Essentially, manufacturers should encourage reports of product defects and injuries because such reports afford manufacturers valuable opportunities to identify product defects, address related problems relatively quickly and avoid surprises in litigation. In conjunction with encouraging customer feedback, the Committee should implement a process by which the information provided can be verified. Upon properly verifying customer reports, the Products Liability Awareness Committee can evaluate the need to warn customers or modify the product's design or production.

2. Documents to Be Retained: Product Complaints and Customer Service

- *Product Failures and Injuries*: compilation of reports of product failures and product-related injuries accompanied by actions taken to review and address the failures and injuries.
- *Product Service History*: documents detailing the history of service performed on the product, including any review and actions taken by the Committee in light of product servicing.

I. Product Recalls and Notices

1. Committee Action

The Products Liability Awareness Committee should assume responsibility for evaluating the need for and designing product notices and product recall campaigns. As part of its deliberations, the Committee must weigh the effectiveness of the notice or recall in reaching end users, as well as the timeliness and thoroughness of the notice or product recall.

2. Documents to Be Retained: Product Recalls and Notices

- *Product Notices and Recalls*: records describing the content of and reasons for product notices and recalls.

J. Employee Education and Training

1. Committee Action

Although training and education programs are generally job-specific, the Products Liability Awareness Committee should assume responsibility for communicating the goals of the company's risk management program to every employee. In addition, the Committee should ensure that training programs for both new and existing employees emphasize the company's commitment to safety and the importance of careful observance of safety standards and procedures. Similarly, the Committee should devise a reporting system to encourage all employees to report production and defect-related problems and reassure employees that such reporting will have no negative consequences.

2. Documents to Be Retained: Employee Education and Training

- *Employee Training Manuals and Related Literature*: records highlighting how employees are trained with regard to safety standards and procedures and encouraged to report problems related to product safety.

V. Conclusion

Recognizing that no manufacturer can completely insulate itself from products liability claims, the best alternative for foreign businesses is to actively pursue measures to manage products liability risks. Foreign manufacturers can begin their risk management by reviewing and selecting the products liability insurance product with the most appropriate coverage and limits. With a keen awareness of the defense strategies in products liability claims, foreign manufacturers can also develop a program of document retention to increase the likelihood of launching a successful defense to any future claim. Lastly, manufacturers can establish a committee or other method to devise standards and review safety issues at every stage of a product's life cycle with the goal of reducing product design and manufacturing defects, minimizing product-related injuries and constantly evaluating ways to improve product safety. Ultimately, foreign manufacturers should be reassured that opportunities do exist to significantly reduce their exposure to products liability losses. Manufacturers must simply be willing to devote substantial financial and human resources to developing and maintaining a product safety program that permeates all facets of manufacturing operations.

John Zulack is a partner and Jennifer K. King is an associate at the law firm of Flemming, Zulack & Williamson, LLP, in New York City.

Jurisdiction and Choice of Law in Cyberspace in Europe

By Marco Berliri

I. Jurisdiction

A. What Is Jurisdiction?

It is common to draw a distinction between jurisdiction to prescribe (or legislate), jurisdiction to adjudicate, and jurisdiction to enforce.[1] Jurisdiction to prescribe has been defined as the authority of a state "to make its law applicable to the activities, relations, or status of persons, or the interests of persons in things, whether by legislation, by executive act or order, by administrative rule or regulation, or by determination of a court."[2] Jurisdiction to adjudicate is the authority of a state to "subject persons or things to the process of its courts or administrative tribunals, whether in civil or in criminal proceedings, whether or not the state is a party to the proceedings."[3] Jurisdiction to enforce refers to "induc[ing] or compel[ling] compliance or to punish[ing] noncompliance with its laws or regulations, whether through the courts or by use of executive, administrative, police, or other non-judicial action."[4]

B. Jurisdiction in Cyberspace

In the context of traditional commerce, the territorial principle might legitimize the state's legislative activities where all the material elements of the Internet transaction are situated in the state. This is not often the case over the Internet, since cyberspace radically undermines the relationship between a particular transaction and a specific physical location. Likewise, computer technology is forcing the reconsideration of the traditional link between geographical location and the power of local governments to assert control over online behavior. Indeed, cyberspace has no territorially-based boundaries: messages can be transmitted from any physical location to any other location without degradation, decay, or substantial delay, and without any barriers. The Internet enables transactions between people who do not know, and in many cases cannot know, the physical location of the other party.

Although a domain name may be associated with a particular Internet Protocol address corresponding to the territory within which the machine is physically located (e.g., an ".it" domain name extension), the machine may move in physical space without any change of domain name, or the owner of the domain name might associate it with a different machine, in a different physical location. Moreover a ".com" (or ".net", ".edu", ".org", ".biz", etc.) domain name may be anywhere, and users, generally speaking, are not even aware of the location of the server that stores the content that they read.[5]

In the cyberspace context, physical borders no longer can function as the sole criterion for the obligations assumed by entering into a new place, because individuals are unaware of the existence of those borders as they move through virtual space. Nor are the effects of online activities tied to geographically proximate locations. Information available on the World Wide Web is available simultaneously to anyone with a connection to the global network.

In this new environment, jurisdiction has become a crucial issue. Anyone doing business in cyberspace needs to know what laws to obey, whether it is a question of taxes, or online privacy, or consumer protection. Both e-businessmen and consumers need to know which rules apply to the borderless geography of cyberspace.

Due to its nature, the Internet effectively propels every business that has a Web site into every jurisdiction in the world, at least from the perspective of the Web site viewer. This global exposure raises significant jurisdictional questions. Courts and legislators must decide where to draw the line in asserting personal jurisdiction over foreign entities whose only contact with the forum state may be that their Web site is accessible in that state. Similarly, they must determine how far to go in providing a home forum for consumers who may have engaged in a transaction with a foreign business that advertised its product on a Web site but that did not specifically seek to transact business in that forum.

The extraordinary orders issued by the Paris *Tribunal de Grande Instance* in the *Yahoo! Inc.* case[6] showed to the Internet community the potentially serious disruptive effects arising from the different approaches adopted worldwide to jurisdiction in cyberspace. The French court ordered Yahoo! Inc., a California-based company promoting, inter alia, auctions on line, to put filtering systems in its U.S. Web site in order to prevent access by French residents to portions of the Yahoo! Inc. auction site on which persons offer to sell World War II memorabilia containing Nazi symbols. In its ruling the court held that the U.S. Web site for Yahoo! Inc. was subject to French jurisdiction simply because it could be accessed from France.

C. The Brussels Convention

Since most legal systems in Europe are civil law systems, solutions to jurisdictional issues are usually based on statutory law. Preliminarily, it is necessary to

draw a distinction between national and international disputes. In the case of a national lawsuit or transaction, the courts of that nation will adopt their own jurisdictional rules. Things are more complicated in cross-border transactions, or in other cases with an international dimension, where rules of more than one country are involved and there is a high risk of conflict of jurisdictions. This risk is even higher in Internet transactions, where the geographic location of the parties is difficult to determine.

Before the entry into force of the Brussels Regulation (discussed below), jurisdiction on commercial matters between different states was regulated by the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (the "Brussels Convention") of 1968,[7] to which all EU Member States are parties, and the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (the "Lugano Convention"), which is in force between EU and other European countries that are members of the European Free Trade Association and incorporates the same concepts as are set forth in the Brussels Convention.[8]

The basic rules set forth in the Brussels Convention, which also apply to cyberspace, are the following:

- Persons domiciled in an EU Member State may be sued in the courts of that state.[9]
- In matters relating to a contract, a party may be sued in the courts of the place of performance of the obligation in question.[10]
- In matters relating to a tort, a party may be sued in the courts of the place where the harmful event occurred.[11]
- Consumers may chose between filing an action either in the country in which they are domiciled or in the other party's country of domicile, while the other party can only sue a consumer in the consumer's country of domicile. This provision applies so long as the consumer has been subject to a specific invitation addressed to the consumer or advertising in the consumer's state of domicile.[12]
- With the exception of disputes involving consumers, the parties to a contract can specify which country's courts have jurisdiction to adjudicate a dispute.[13]

As early as 1993, the Commission was concerned that under the existing rules consumers were granted insufficient protection. The emergence of the Internet and the increase in e-commerce amplified such concerns with the existing jurisdiction rules. In 1997, the European Commission proposed new legislation to address these issues.[14]

D. The Brussels Regulation

As mentioned above, in 1997 the EU Commission began working on a number of projects designed to harmonize electronic commerce law within the internal European market.[15] The Brussels Regulation is one of the products of this effort.

The 1997 proposal for new jurisdiction rules was met with a long and contentious debate that ended on 22 December 2000, when the Council of the EU issued a new regulation ("Brussels Regulation")[16] aimed at unifying the rules of conflict of jurisdiction in civil and commercial matters and at simplifying the formalities for recognition and enforcement of judgments. It is significant that the form chosen was a regulation, binding in its adopted form in all Member States, rather than a convention or a directive: A convention would have had to have been negotiated between the Member States and a directive would have needed to have been implemented individually by each Member State, and could have resulted in varying national provisions. The Commission, however, wanted to have a uniform and certain set of rules and at the same time wanted a law that would be immediately binding and enforceable in the Member States without any delays caused by prolonged implementation or negotiating processes.

It is important to stress that the Brussels Regulation does not affect the main structure of the Brussels Convention, but introduces a number of changes, some of which address e-commerce and consumer protection. Accordingly, one of the most important changes to the existing rules is the broadening of the nature and scope of activity that can be the basis for personal jurisdiction over defendants in actions brought by consumers. Under the Brussels Regulation, the courts of the consumer's home country will have jurisdiction over a foreign defendant if the latter ''pursues commercial or professional activities in the Member State of the consumer's domicile *or, by any means, directs such activities to that Member State . . . and the contract falls within the scope of such activities*."[17] The phrase ''by any means'' is specifically intended to cover e-commerce transactions and to give consumers the ability to bring a lawsuit relating to any contracts executed via the Internet in their own country of domicile.[18]

However, given its broad language, the Brussels Regulation could also invite consumers to argue for personal jurisdiction over defendants in consumer transactions that were not concluded via the Internet but that nevertheless are related to and fall within the scope of the foreign defendant's Web site. Indeed, other commentators have already argued that, under the

Brussels Regulation, mere advertisement on a Web site could suffice to establish personal jurisdiction if the legal claim relates to the advertised products.[19] According to these commentators, ''a consumer who, while on a trip, buys a computer in the country of a company making a promotion on its Web site, may be able to bring an action against the vendor before the court of the consumer's own domicile.''[20] While the Commission has not stated that a "passive" Web site should not be basis for jurisdiction,[21] it has, nevertheless, indicated generally that it intended a broad interpretation of the ''directs-by-any-means'' language. According to the Commission, the new regulation ''equates the offer of goods and services via the Internet with an invitation or advertising by businesses which 'by any means . . . direct their activities towards that Member State.'''[22]

The Brussels Regulation abolishes the requirement that, in order for consumers to be able to sue in their home country, the consumers must have taken the steps necessary for the conclusion of their contracts in their home country.[23] This requirement currently precludes home-forum suits by consumers who have contracted from a country other than their own or who cannot prove that they contracted from their home country. In contrast, the Brussels Regulation merely provides that the consumer contract must fall within the scope of the activities the defendant directed to the consumer's state, without specifying that the consumer must have contracted from that state.[24]

This controversial proposal has been the subject of fierce lobbying by business and consumer groups. Industry groups claim it would hinder the growth of e-commerce, by making small- to medium-sized businesses reluctant to set up Web sites for fear of being subject to the jurisdiction of the courts of every other country.[25] Consumer groups argue the opposite, saying confidence in buying online—an important factor affecting e-commerce growth—would be enhanced if people knew they could get redress in their own courts.

The Brussels Regulation also leaves unchanged the existing rule that any forum selection agreement between a business and a consumer providing for a forum other than the courts of the home country of the consumer is null and void, unless it is entered into after the dispute has arisen.[26]

Interestingly, the EU Commission argued that an industry-friendly approach would put the EU e-commerce sector at a significant competitive disadvantage to e-commerce in the United States, because it believed that the United States already had strong consumer protection laws. According to the European Commissioner for Health and Consumer Protection,

> To deny EU consumers the opportunity to sue in their home country would put the EU e-commerce sector at a great competitive disadvantage to the U.S. sector. U.S. consumers can currently sue EU e-businesses in the U.S. for breach of U.S. consumer law. Commissioner Pitofsky of the FTC whom I met last week confirmed that U.S. consumers should be able to sue EU-businesses in their own courts. Thus the approach advocated by the [opponents of the Brussels Regulation] would lift the equivalent obligation on US e-businesses operating in the EU, thereby giving them a huge competitive advantage.[27]

E. The Brussels Regulation's Effect on Non-Member States

While the Brussels Regulation officially applies only to EU Member States (as does the Brussels Convention), the new rules might affect jurisdiction over non-EU businesses, at least for all those countries that incorporate the rules of the Brussels Regulation in the internal conflict of laws statutes.[28] The implications of the Brussels Regulation for non-EU companies may therefore be substantial. For instance, a U.S. company doing business online with EU consumers may be sued in the courts in the consumer's home country. European courts may assert jurisdiction regardless of how or where a consumer purchased the product so long as the company's Web site advertising the product was accessible in the forum country.[29]

II. Choice of Law

A. The Rome Convention

Whereas the Brussels Regulation, and the Brussels Convention before it, govern what court has jurisdiction over a case, the Rome Convention on the Law Applicable to Contractual Obligations of 1980 (Rome Convention) [30] governs what law applies in a particular case. The main provisions set out in the convention are the following.

1. Freedom of Choice

The main principle of the convention is the parties' freedom to choose which law shall apply to the agreement entered between them.[31] The choice does not have to be in writing, but it must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. This requirement gives rise to any number of possible questions of interpretation in the cyberspace environment.

2. The Closest Connection

In the absence of any valid agreement regarding choice of law, the applicable law will be that of the country which is most closely connected to the agreement. Which country the agreement is most closely connected to will be assessed on the basis of where the characteristic performance of the agreement is to be effected. There is a general presumption that "the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a corporate body, its central administration."[32]

3. Consumer Contracts

Under the Rome Convention, even in a consumer-relation the parties are in principle free to choose applicable law. However, the consumer is protected by law to the extent that he can not by such an agreement be deprived of the protection that is given to him by mandatory rules of the law of the state in which he habitually resides. This exemption is applicable only if (i) the consumer, before concluding the contract, has been subject to a special invitation, or advertising by the other party in the state of the consumer's habitual residence; or (ii) the consumer has taken all necessary steps on the consumer's part for the conclusion of the contract in that country.[33] As pointed out above, the Brussels Regulation has abolished the requirement that, in order for consumers to be able to sue in their home country, the consumers must have taken the steps necessary for the conclusion of their contracts in their home country.[34] In contrast, the Rome Convention still provides that the consumer must have been subject to specific invitation and must have contracted from his own state. This of course might give rise to a number of issues when a transaction is carried out online.

B. Rome II

In the same way that the European Commission updated and converted Brussels from a convention to a regulation, it seeks to apply that process to Rome to institute a regulation known as Rome II. The European Commission released in June 2002 a draft regulation aimed at harmonizing the rules with respect to the law applicable to non-contractual obligations.[35] This initiative is part of the work under progress to ensure that the courts of all EU Member States apply the same law to cross-border disputes, thus facilitating the mutual recognition of judicial decisions throughout the European Union.

The draft Rome II would mean a departure from the "country of origin" principle set out in the E-Commerce Directive.[36] Rome II follows the Commission's revision of the Brussels Regulation in 2000. The draft Rome II Regulation aims to harmonize the rules regarding the settling of disputes using the laws of the country where the default took place. This "country of destination" principle has received strident criticism from business associations because it would not be necessary for the proper functioning of the internal market as required under Article 65 of the EC Treaty. For many non-contractual obligations such as the default rule, unfair competition and defamation, the Rome II proposal imposes the application of the law of the country where the damage occurs or where the victim is located. In the commercial context where a product or service is provided across borders, the applicable law generally would be the law of the country in which the damage occurs or the victim is located. According to representatives of industries, this would generally be the law of the recipient of the product or service, and for the supplier of any pan-European product or service under the proposals, the effect would mean that he is subject to the divergent laws of all fifteen Member States.

The Commission proposes that the new Regulation should not apply to industries in which the European Union has already set different cross-border rules (as set out in Article 23 of the Regulation). Since the EU has already adopted the E-Commerce Directive, which states that the laws of the country where the supplier or Web site is situated should apply in disputes, according to some commentators, e-commerce would be exempted.[37]

Endnotes

1. *See* Restatement (Third) of Foreign Relations Law, Introductory Note to Part IV, at 230-1; M.N. Shaw, International Law 456-57 (4th ed. 1997).
2. Restatement (Third) of Foreign Relations Law § 401(a).
3. *Id*. at § 401(b).
4. *Id*. at § 401(c).
5. *See* Johnson and Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 Stan. L. Rev. 1367 (1996).
6. *See League Against Racism and Antisemitism v. Yahoo! Inc.*, No. RG: 00/05308 (2000), available at www.cdt.org/speech/international/001120yahoofrance.pdf, visited on 10 Feb. 2002.
7. Official Journal C 027, 26/01/1998 p. 0001-0027.
8. 28 I.L.M. 620. Members of the European Free Trade Association are the EU Member States, Iceland, Norway and Switzerland. For the purpose of this article any reference to the Brussels Convention includes the Lugano Convention.
9. Art. 2.
10. Art. 5.
11. Art. 5.
12. Arts. 13 and 14. A consumer is defined under Art. 13 as a person who concludes a contract ''for a purpose which can be regarded as being outside of his trade or profession.''
13. Art. 17.

14. Proposal for a Council Act Establishing Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters in the Member States of the European Union (1998) Official Journal C 033 (1998) at 20-36.

15. Directive on Electronic Commerce adopted by the European Parliament and Council in June 2000 (2000/31/EC) and Directive on Electronic Signature of 1999 (1999/93/EC).

16. Council Regulation No. 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 22 Dec. 2000, 2001 O.J. (L 012) 1-23.

17. Art. 15(c) of Brussels Regulation (emphasis added).

18. See European Commission, Explanatory Memorandum to the Proposal for a Council Regulation on Jurisdiction, COM (1999) 348 of 14 July 1999, available at http://www.europa.eu.int/comm/justice_home/pdf/com1999-348-en.pdf. The Commission pointed out that ''the concept of activities . . . directed towards a Member State is designed to make clear that [this provision] applies to consumer contracts concluded via a Web site accessible in the State of the consumer's domicile.''

19. Powell & Turner-Kerr, *Putting the e- in Brussels and Rome*, 1999 I.C.C.L.R., 361, 363.

20. *Id*.

21. In this regard U.S. courts apply a distinction between active, interactive and passive Web sites. Active Web sites include sites through which a "defendant clearly does business over the Internet," such as where the defendant ''enters into contracts with residents of a foreign jurisdiction that involve the knowing and repeated transmission of computer files over the Internet." A passive Web site does little more than make information available to those who are interested in it. In between the active and passive Web sites are "interactive" Web sites, where a user can exchange information with the host computer.

    Under the analysis of the U.S. courts, an active Web site is always grounds for personal jurisdiction, a passive Web site is not enough, and jurisdiction is determined in the case of interactive Web sites by examining the level of interactivity and the commercial nature of the exchange of information that occurs on the Web site.

22. Opinion of the Economic and Social Committee on the Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, CES 233/2000–99/1054 CNS, March 2000.

23. *See* European Commission, Explanatory Memorandum to the Proposal for a Council Regulation on Jurisdiction, COM (1999) 348 of 14 July 1999, at 16.

24. *See* Art. 15 of the Brussels Regulation.

25. *See* Eaglesham, *Web suits plan attacked*, Financial Times, 6 Nov. 2000.

26. *See* Art. 16 of the Brussels Regulation.

27. *Id*.

28. In Italy, for example, Law 218 of 31 May 1995 (New System of International Private Law) expressly makes reference to the rules set forth in the Brussels Convention to resolve a conflict of jurisdiction with non-Member States.

29. Powell & Turner-Kerr, note 19 *supra*, 1999 I.C.C.L.R. at 363.

30. Official Journal C 027, 26/01/1998 pp. 0034-0046.

31. *See* Art. 3 of the Rome Convention.

32. Art. 4 of the Rome Convention.

33. Art. 5 of the Rome Convention.

34. *See* Art. 15 of the Brussels Regulation.

35. The text of the draft is available at: http://www.europa.eu.int/comm/justice_home/unit/civil/consultation/index_en.htm, visited on 12 Sept. 12, 2002.

36. Directive on Electronic Commerce adopted by the European Parliament and Council in June 2000 (2000/31/EC).

37. Mazumdar, *EU Actions on Jurisdiction, Choice of Law Watched Closely by E-Commerce Interests*, BNA's Electronic Commerce & Law Report, Vol. 7, No. 12, 2002.

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Ten Important Points to Remember About International Estate Planning

By Michael W. Galligan

Introduction

With the accelerating globalization of economic relations and the compression of travel and communications distances between countries, increasing numbers of United States citizens and residents find themselves holding property in many jurisdictions outside the United States and many foreign persons find themselves holding property in the United States. So pervasive have cross-border property interests at the individual and family level become that no U.S. trusts and estates advisor, whether lawyer, accountant, or financial consultant—no matter how strong the advisor's focus on U.S. domestic clients may be—can afford to be ignorant of the issues and potential problems that may confront a client with even the most tangential international connections.

For example, the conferral of a power of appointment over a trust or even the mere right to appoint successor trustees of a trust could cause a domestic trust to be treated as a foreign taxpayer for U.S. income tax purposes should that power ever fall into the hands of a person who is not a U.S. citizen or U.S. income tax resident. To take another example, perhaps more widely known, bequests of property to a spouse who is a U.S. permanent resident but not a U.S. citizen are no more eligible for the estate tax marital deduction (without the use of a qualified domestic trust) than a bequest to a foreign spouse who never set foot in the United States.

The purpose of this article, therefore, is to provide a basic outline of the major issues and challenges that every U.S. estate planner should be aware of—whether advising clients who clearly have multinational families or multinational property holdings or advising clients who may find themselves unexpectedly confronting international estate issues simply by virtue of the growing internationalization of investments and finance and interpersonal relations themselves.

I. Unlike the citizens of many other countries, all U.S. citizens are subject to worldwide U.S. transfer taxation as well as worldwide U.S. income taxation, regardless of the citizen's domicile or residence.

A. General Principle

The United States is one of the few countries in the world to have a worldwide transfer tax system as well as a worldwide income tax system. The rules for determining who is subject to the worldwide transfer tax system and who is subject to the worldwide income tax system, while often overlapping in their practical effect, are not the same—except for one category, U.S. citizens. A U.S. citizen is subject to U.S. income tax on the citizen's worldwide income and subject to the U.S. gift, estate and generation-skipping transfer taxes with regard to all of the citizens' property transfers, regardless of the location of the property, whether during life or at death.[1]

When dealing with citizens of other countries who own assets in the United States or whose situations somehow impact on planning for U.S. persons, one should not assume that they are subject to worldwide taxation on the same basis as they would be if they were U.S. citizens. Most other countries tax on the basis of residence not nationality. Thus, if one of their nationals has habitually resided in the United States for a substantial number of years, that person may well be subject to that nation's income and transfer taxes only with respect to income earned and property located in that country.

The fact that the United States does impose its transfer taxes on a worldwide basis means that the estate planner to a U.S. citizen who lives abroad or who owns property abroad has a very complicated task. The planner must take into account the way foreign property and inheritance laws may affect the disposition of the client's property and, in the case of U.S. citizens living abroad, how foreign property and inheritance laws may even affect the disposition of the client's U.S. property. In addition, the planner must also carefully consider the impact of United States transfer taxes on gifts and bequests of foreign property as well as the impact of whatever transfer taxes the relevant foreign jurisdictions may impose on those properties. In the case of a U.S. citizen living abroad, the planner must also consider the possibility that, under the tax rules of the U.S. citizen's country of residence, that country may also claim the right to tax the U.S. citizen's property located in the United States. If so, the planner must address how the client's property can be organized to avoid being fully taxed both by the foreign country and the United States.

B. Enforceability

As to a U.S. citizen living abroad, one may ask how the United States can effectively enforce its claim to tax the U.S. transfers of the U.S. citizen's property located abroad. If the U.S. citizen has no property in the United States and none of the U.S. citizen's heirs are U.S. citizens or residents, the United States may well have difficulty enforcing its taxes. However, the general reluctance of countries to enforce other countries' tax laws is gradually being weakened by international efforts, especially in Europe, not only to fight money-laundering and fraudu-

lent transfers of funds but also to promote tax harmonization and the flight of funds to tax havens. In any event, most U.S. citizens who live abroad own property in the United States and wish to give or leave their property to persons who are U.S. citizens or residents. The United States can seek payment of any unpaid taxes from any beneficiary or donee of such property who lives in the United States or over whom the United States has jurisdiction.

For example, the United States will have an estate tax lien against the U.S. property of a U.S. citizen living abroad, which can be seized to satisfy U.S. transfer tax obligations related to the foreign property as well as the U.S. property. If the property in the United States is subject to administration, the person appointed to administer the property will have to take into account the U.S. tax liabilities before distributing the property, or else risk personal liability for the unpaid taxes. Thus, in virtually all cases involving U.S. citizens living abroad, the consequences of the U.S. transfer tax system must be taken into account from a practical as well as a legal point of view.

II. All U.S. non-citizen domiciliaries are subject to worldwide transfer taxation but some legal immigrants and tax residents, while subject to worldwide U.S. income taxation, may not be subject to worldwide U.S. transfer taxation.

A. Different Treatment

When dealing with U.S. persons who are not U.S. citizens, it is important to remember that the rules for determining the scope of U.S. taxation are not identical for income purposes and for transfer tax purposes.

Take a legal immigrant, i.e., a person who is a U.S. permanent resident or "green card holder." To obtain a green card, one must have an intent to take up permanent residence in the United States. However, there is no requirement that a person intend to live in the United States for the rest of that person's life. Thus, holding a green card may be very persuasive evidence of having the intent to make the United States one's domicile, but that inference can be rebutted by showing the close connections of the person to another country and the intention of the person to return or move there in the future. The same may be also true of a person who is subject to worldwide U.S. income taxation because the person established a tax residence here simply by spending a substantial number of days here over a period of time.

B. Consequences

If a U.S. permanent resident or a U.S. tax resident does not establish a U.S. domicile, that person will be treated for transfer tax purposes virtually the same as a person who is neither a U.S. citizen nor a U.S. resident ("nonresident alien"). The only gifts that will be subject to U.S. gift tax will be gifts of U.S. tangible property and real property. All other gifts, including gifts of financial assets, will be completely free of U.S. gift tax. At death, that person's U.S. financial assets as well as U.S. tangible personal and real property will be subject to U.S. estate tax but the United States will not be entitled to tax any of that person's non-U.S. property.

For estate tax purposes, one difference between the treatment of U.S. permanent residents and tax residents, on the one hand, and nonresident aliens, on the other should be noted: nonresident alien decedents do not generally pay U.S. estate tax on U.S. bank deposits and accounts nor on most U.S. debt instruments issued after July 1984, due to a legislative dictate that these assets, when owned by nonresident aliens, are treated as having a situs outside the United States.

III. The U.S. person with assets abroad may become subject to rules about mandatory inheritance, the procedures for making wills, and the rights of spouses and creditors that are very different and inconsistent with U.S. law.

A. Forced Heirship

Foreign property and inheritance regimes can be very different from those we are accustomed to in the United States. Perhaps the best known difference is that, while most states in the United States give parents virtually complete freedom over whether to bequeath property to their descendants at death, most civil law countries require that parents leave a considerable portion of their estates to their descendants ("forced heirship").

Take Switzerland, for example: the rules that guarantee to children a portion of an estate are based on the Swiss rules about intestate distribution. If there is no will and the decedent is survived by a spouse and issue, the surviving spouse is entitled to one-half of the estate and the issue share the other one-half of the estate. If there is a will, the spouse is entitled to one-half of her intestate share or one-quarter of the estate and the children are entitled to three-fourths of their intestate share or three-eighths of the estate, all regardless of any inconsistent provisions of the will.

In France, to take another example, if there is only one child, the child or that child's issue are entitled to one-half of the estate; if there is more than one child, the children or issue have a right to two-thirds of the estate. The decedent may direct that the surviving spouse receive either the entire portion of the estate that is not required to go to issue, or one-quarter of the estate and the balance in usufruct (a form of interest very close to a common law life estate) during the surviving spouse's lifetime, or the entire estate in usufruct. In the case of a

decedent who dies leaving no issue and no spouse but one or both parents, one-half of the estate must go to the parent or parents, again, regardless of what the will may provide.

Finally, in Brazil, the decedent may dispose of only one-half of the decedent's estate freely, if there are any issue or parents surviving.

B. Other Differences

Another important legal difference is that many countries have a system of community property (like the states of the United States that were influenced by Spanish or French law), with the result that property acquired in one of these countries during a marriage may be automatically considered to be owned equally by each spouse, regardless of who actually paid the consideration for the property or took title to it.[2]

In addition to major differences in property law, the formalities and procedures for executing a valid will can be very different from those we are accustomed to in the United States and the procedures for seeking the recognition of a will, administering property, and seeing to the ultimate distribution of the property can be equally different. In many civil law countries, for example, legal officers with the title of "notary," essentially special purpose lawyers for the administration of property, play a major role in the making of wills and in their implementation. Executors are often not appointed and, where used, their power is more restricted than that of their American counterparts.

The idea that an estate constitutes a separate legal or tax entity is especially foreign to most civil law jurisdictions. For example, a civil law executor could not undertake a refunding obligation without being personally responsible for the obligation. In another important variation, beneficiaries of non-U.S. estates can find themselves sharing responsibility for their decedent's liabilities, without limitation to the property inherited from the deceased, unless special steps are taken to avoid this result within specified time periods after the decedent's death.

C. Choice of Law

Obviously, before attempting to determine the tax aspects and consequences of a client's situation, it is necessary to understand the nature of the client's property interests in the various countries where those interests are located, the identity of the persons who will be the donees or beneficiaries of the client's property under the rules of the respective countries, and the legal characteristics of entities in different countries used by the client to hold these interests.

But to understand these matters, it is important to ensure something else that might seem so obvious as to be overlooked: that the planner is looking to the proper law that will govern these rights, claims and legal consequences. Choice-of-law in international estate planning is a fascinating but difficult topic. In order not to break the general progress of the discussion in this article, an outline of some of the most important considerations is contained in Appendix A. Briefly, many countries do not make the distinction most common law jurisdictions make between the law of situs for real property and the law of domicile for personal property. In addition, a not insignificant number of countries consider the law of a decedent's nationality rather than domicile or residence to be controlling. In the end, the moral of the story is that it is never wise to make a judgment on a question of governing law or on the ultimate impact of foreign inheritance or estate law without seeking competent legal advice in the country that concerns you.

IV. The U.S. person with assets abroad may be able to avoid the application of foreign inheritance law by holding foreign assets through trusts, corporations or limited liability companies.

In planning the estate of a U.S. person who owns property or has other interests in many different countries, as indicated in Part III above and Appendix A, one can become embroiled in foreign substantive and choice-of-law rules that are not always complementary or consistent—to say nothing of the parallel tax rules and their ramifications. Therefore, one of the main goals of estate planning for a U.S. client who lives abroad or who has property abroad is to organize the client's property interests in a way that will insulate the properties from the application of local inheritance and property regimes and from the necessity of employing local forms of wills and local procedures for the distribution of inherited property.

The ideal way to accomplish this goal is to organize one or more asset-holding entities in a jurisdiction whose rules best permit the client to accomplish the client's goals or which will at least complement the rules of the jurisdiction you expect to govern the client's inheritance. The entities will generally be organized so that they will survive the client's death, with the result that the jurisdictions where the underlying properties are located will have no reason to take account of the client's death. That will be the result—and this is often the most important factor—if the jurisdictions where the underlying properties are located will recognize the entities as the legal and equitable owners of the property and will not "look through" them and impose any legal rights or obligations on the client as the owner of the entities.

There are three principal candidates from which to select entities that can be used to organize and hold a U.S. client's interests abroad:[3] trusts; corporations; and limited liability companies.

A. Trusts

The institution of the trust, with its separation of right to title and rights to beneficial enjoyment, is deeply woven into the fabric of U.S. estate planning. It provides flexibility in providing for beneficiaries, especially for those to whom it would be unwise to transmit property directly, whether because of issues of capacity, financial responsibility, future need, or protection from creditors. It also provides the mechanism by which a wide variety of tax credits, exemptions and deductions can be preserved. From the income tax side, trusts can be easily structured as grantor trusts, so that the client's income tax planning need not be upset by steps that are designed exclusively for estate planning purposes.

The institution of the trust, of course, is well known in many common law countries, and a number of offshore jurisdictions have adopted it. However, it is still not widely recognized in most civil law jurisdictions. The fact that many jurisdictions do not have the institution of the trust means that non-trust jurisdictions often have difficulty in dealing with trusts that seek to hold property or do business. There is often the risk that the property held by the trust will be treated as the personal property of the trustee, subject to the personal creditors of the trustee and possibly even treated as part of the trustee's personal estate at death. It is often unclear how far a foreign court will go in recognizing the judgments of a court in the trust's home jurisdiction about the rights of beneficiaries that require extra-territorial effect.

The Hague Convention on the Law Applicable to and the Recognition of Trusts was proposed to avoid many of these problems by, among other matters, conferring legal recognition by civil law countries for trusts established in common law countries Unfortunately, to date, only Italy and The Netherlands, among the civil law countries, have ratified the Convention. The fact that a trust cannot freely act across national boundaries therefore often makes it less than ideal as a vehicle for holding foreign assets of a U.S. client.

B. Corporations

Corporations are well known as entities primarily designed to enable individuals to pursue commercial objectives, collect and organize capital, and insulate individual owners from liabilities of corporations when those liabilities exceed the capacity of corporations to satisfy them. Unlike a trust, however, corporations (with the possible exception of certain "family companies" under Swiss or Liechtenstein law) cannot operate as a direct mechanism for transmitting property at death. The directors of a corporation have a duty to the shareholders to operate the business of the corporation for the benefit of the shareholders, but they cannot decide to whom ownership of the corporation will pass upon a shareholder's death. That must be determined by the will or other testamentary instrument of the owner of the corporate shares.

Corporations organized in the United States can also pose certain income tax complications. A "C" corporation is a separate taxpayer with responsibility to file income tax returns (regardless of the level of income) and to pay income tax at the corporate level, while shareholders are taxed again on dividends and other forms of income distributions and also on the gains realized upon certain stock redemptions and the partial or complete liquidation of the corporation. While shares of a corporation that pass upon the death of an owner are entitled to a step-up in cost basis, there is no step-up in the cost-basis of the underlying assets.

In general, adoption of "S" status effectively removes the double taxation at the corporate and shareholder level because the corporation acts essentially like a conduit or pass-through entity, with the stockholders being liable for their allocable shares of the corporation's items of income and deduction. It does not change the fact that, while the shares of an owner will be entitled to a step-up in cost basis, there is no corresponding step-up in the cost-basis of the underlying assets. Moreover, there are a number of restrictions and limitations on the use of "S" corporations. These include a disqualification of any person who is not a U.S. citizen or U.S. resident from being a shareholder, a limitation on the number of shareholders to seventy-five, and rather rigid rules as to what conditions must obtain for a trust to be a shareholder.

C. Limited Liability Companies

Limited liability companies generally offer an optimum combination of organizational and tax advantages. Like shareholders of a corporation, members of a limited liability company enjoy protection from liability for the company's liabilities as along as the company is properly organized and capitalized and company formalities are respected in the operation of the company's business. At the same time, a limited liability company will be treated for income tax purposes like a partnership, as a pass-through entity, with the members picking up their allocable share of the company's taxable income and deductions as part of their own income and deductions. Consequently, the problem of double taxation inherent in a "C" corporation are avoided without having to fit within the restrictive limitations of an "S" corporation. Of particular note is the ability of a limited liability company, like a partnership, to obtain a step-up in basis with respect to the member's pro-rata share of the assets held by the company at the death of a member and, of course, upon the purchase of a membership interest. In addition, all of the flexibility that a partnership has with regard to the gifting of limited partnership interests also appears to be available to membership units in a limited liability company.

V. The U.S. person domiciled abroad may be subject to double transfer taxation unless the U.S. person lives in a country with which the United States has a beneficial estate and gift tax treaty.

There is no U.S. gift tax credit for gift taxes paid to a foreign country. There is a U.S. estate tax credit for "death" taxes paid to a foreign country, but there are two significant limitations on this credit, which effectively limit the scope of the credit to some or all of the death taxes paid to a foreign country only on property located in that country. The first limitation is generally designed to ensure that no greater percentage of foreign inheritance taxes paid will be allowed as a credit against U.S. taxes than that percentage of the total foreign inheritance taxes that is imposed on the foreign property that is also being taxed by the United States.[4] The second limitation is designed to ensure that no greater percentage of the total U.S. tax paid will be allowed as a credit than that percentage of the total U.S. taxes imposed on the decedent's foreign property.[5] The amount of the foreign death tax credit is the lower of the amount of foreign death tax calculated under the first limitation or the amount of U.S. tax calculated under the second limitation.

The result of these limitations is that the statutory foreign death tax credit can, under certain circumstances, present very little relief for U.S. citizens or domiciliaries who reside in, or for some other reason are subject to death taxes in, a foreign country on a substantial part or all of their worldwide estates. Take, for example, a U.S. citizen who maintains ninety percent of the citizen's worldwide assets in the United States but who resides in a foreign country that imposes inheritance taxes on a worldwide basis on its residents. Under the first limitation (which would apply here because the credit is limited to the *lower* of the two limitations), only ten percent of the foreign tax would be eligible for the credit. Assuming the foreign tax rate is the same or lower than the U.S. rate, ninety percent of the estate would be effectively subject to two death duties, with no mitigation of one against the other. Only if the rate of the foreign tax exceeded the U.S. rate would there be a possibility that some portion (and a very small portion at that) of the available credit would shelter any portion of the U.S. tax on the other ninety percent.

A U.S. citizen or domiciliary will possibly be entitled to more generous relief from double transfer taxation only if that person is fortunate to be a resident of a country with which the United States has entered into an estate tax treaty. The United States has entered into estate tax treaties that are currently in force with Australia, Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, The Netherlands, Norway, South Africa, Sweden, Switzerland and the United Kingdom. The treaties with Australia, Austria, Denmark, France, Germany, Sweden and the United Kingdom also cover gift taxes. The treaty with Australia is of very little current use, since Australia has effectively eliminated inheritance taxes. The same may be true of the treaty with Italy, which has recently enacted legislation that appears effectively to repeal most Italian inheritance taxes. The United States has also entered into a Protocol to the U.S.-Canada Income Tax Treaty, which contains some partial amelioration of double deathtime taxes that can result from the Canadian tax on a decedent's deemed or unrealized capital gains.

A. Situs Treaties

The U.S. estate tax treaties negotiated in the decade after World War II used a combination of situs and credit rules. In broad terms, under a situs treaty, assets belonging to a national or domiciliary of one state party that are deemed located in the other state party are permitted to be taxed by the other state party, subject to (i) an allocation against the other state's tax of a proportionate share of any exemption offered by the other state party and (ii) a prohibition on considering property in the national or domiciliary state in calculating the rate or amount of tax. The state of nationality or domicile is usually permitted to tax the same property, but is required to give a credit against its tax for the tax paid to the situs state. In the case where both countries tax because of domicile or citizenship connections, a credit is usually available equal to the lower of the two countries' taxes, with each country being required to give a credit against the other country's taxes based on its share of the total taxes that would be due if no foreign death tax credits were available.

B. Fiscal Domicile Treaties

The U.S. estate tax treaties negotiated in the seventies and eighties are predicated on a determination, for treaty purposes, of the "fiscal domicile" of the donor or decedent. If a person is considered by each country to be a domiciliary of that country, each of these treaties contains a set of "tie-breaker" rules designed to produce a determination of "fiscal domicile" for treaty purposes. Like the "situs" treaties, but on a more restricted basis, a state party that is not the fiscal domicile is permitted to tax certain forms of property located in that country, and the domiciliary country is required to give a credit for the tax paid to the situs country. In cases where both countries are permitted to impose their tax on an unrestricted basis (assets located outside the country as well as within), the country of domicile is deemed to be the primary taxing authority, and the country of nationality is generally required to give a credit against its taxes for the taxes paid to the country of domicile.

The moral of the story with regard to a U.S. citizen or domiciliary living abroad is that choosing the right country of residence abroad with a favorable approach to estate taxes or with a favorable estate treaty can be as

crucial to the maintenance of a family's wealth as choosing the country with a favorable approach to income taxes or a favorable income tax treaty. Of course, most advisors are only consulted by a family long after decisions about residence have been made for many other reasons. Still, if the country where the client resides does have an estate tax treaty with the United States, it may be possible to organize a client's assets in a way that will make the client's family eligible for the best treatment under the treaty. It is crucial to run calculations on what the client's foreign inheritance or death tax filing and payments would look like as well as the client's U.S. tax filings, to be sure that inconsistent treatment of certain assets or interests the client may have will not cause the treaty protections against double transfer taxes to be ineffective.

VI. It is very easy for a trust to be treated as a foreign trust for U.S. income tax purposes, but in many cases this will create substantial disadvantages for U.S. grantors and beneficiaries.

The United States has given a great deal of attention to the tax treatment of foreign trusts, especially when U.S. persons establish foreign trusts or when U.S. persons have beneficial interests in foreign trusts. Prior to 1996, it was relatively difficult for a trust with significant ties to U.S. persons to be a foreign trust unless it was administered from abroad and held substantial foreign assets. That was all changed by legislation enacted in 1996 that set up a set of bright-line tests for determining whether a trust was domestic and defined all trusts that did not meet these tests as foreign trusts. Because the tests are fairly exacting in the U.S. connections they require of a trust to qualify as a domestic trust, they make it very easy for trusts that to the untutored eye look very domestic to be treated as foreign trusts.

The 1996 legislation imposed two basic set of tests for determining whether a trust is a domestic trust. Failure to satisfy either set of tests causes the trust to fail to be a domestic trust and to qualify as a foreign trust: (i) a United States court must be able to exercise primary supervision over the trust (the "Court Test"); and (ii) one or more U.S. persons must have the authority to control all substantial decisions of the trust (the "Control Test").

A. The Court Test

A United States court must be able to exercise primary supervision over the trust. This means that a United States court must have the authority to determine substantially all issues about the administration of the trust. The "court test" means that a trust governed by an agreement that attempts to give a foreign court exclusive jurisdiction over the trust will ordinarily not qualify as a U.S. trust, even if U.S. citizens control all the major decisions of the trust.[6] The final regulations provide for three special situations in which a trust would be deemed to have satisfied the "court test": (i) when a trust is registered by an authorized fiduciary or fiduciaries within the United States pursuant to a state statute similar to Article VII of the Uniform Probate Code; (ii) when a trust created under a will is admitted to original probate within the United States, if all trust fiduciaries have been qualified as trustees by a U.S. court; and (iii) when fiduciaries or beneficiaries of a trust take steps to cause the administration of the trust to be subject to the primary supervision of a U.S. court.

B. The Control Test

United States persons must exercise control over all substantial decisions affecting the trust. United States citizens and United States residents qualify as United States persons for purpose of this requirement; a U.S. citizen trustee need not reside in the United States to qualify. Domestic corporations and partnerships may also qualify as U.S. trustees. Substantial decisions include all types of decisions that trustees are required to make under the trust agreement or under applicable law that are not ministerial. Thus, U.S. persons must be able to control all discretionary decisions as to distributions, investment of the trust, allocation between income and principal, and so forth. Delegation of investment decisions by a trustee to a foreign investment advisor would not cause the trust to fail the "control test" as long as a U.S. person can terminate the investment advisor's power to make investment decisions at will.

C. Analysis

It is especially important to be clear about a trust's U.S. tax status when advising clients who are considering establishing foreign trusts or, perhaps most significantly, may be the beneficiaries of foreign trusts. Since 1979, the United States has sought to dissuade U.S. persons from establishing foreign trusts with two different methods: U.S. persons who establish foreign trusts for the benefit of U.S. beneficiaries are treated as owners of the foreign trust property for U.S. income tax purposes and substantial penalties fall on any U.S. person who declines to disclose that he or she has established a foreign trust of this kind and to report fully the income and realized gains of the trust and pay the corresponding taxes. Although U.S. persons who establish foreign trusts that do not have any U.S. beneficiaries are not required to report and pay tax on the income and gains derived from the trust property as if they still owned it, they must pay a capital gains tax on the built-in gain on all appreciated assets transferred to the trust as if the transfer to the foreign trust constituted a sale of the assets.

The United States has been concerned for many years with the possibility that U.S. beneficiaries of foreign trusts that do not qualify as "grantor trusts" for U.S. income tax purposes (i.e., trusts where the person who

funded the trust is deemed to still own the trust property) would be able to defer taxes on the income from foreign trusts and have an unfair advantage over the beneficiaries of many domestic trusts. In an effort essentially to compel these foreign trusts to distribute income to U.S. beneficiaries on a current basis so that the beneficiaries would have to report this income as part of their receipt of distributable net income, U.S. beneficiaries who receive distributions of accumulated income are required to pay a tax that is supposed to roughly mimic the tax the beneficiaries would have paid if they had received the income currently.

That might not be so bad in and of itself but there are two additional factors. First, undistributed capital gains are treated as ordinary income, so that distributions that effectively pass out the proceeds of sales of trust property are also subject to U.S. income tax in the hands of the beneficiaries at ordinary income tax rates. Second, there is an interest charge on the payment of taxes on distributions of accumulated income and gains which, since 1996, is computed on a compounded basis, using the prevailing Treasury rates for underpayment of taxes. The effect of this treatment of distributions from foreign trusts, especially when they are deemed to carry out many years of accumulated income and gains, is to cause the beneficiaries to essentially forfeit virtually all of their trust distributions except for the receipt of the original principal contributed to the trust and any current income and gains.

VII. The U.S. citizen with a spouse who is not a U.S. citizen will not be eligible for the gift tax marital deduction and will not be eligible for the estate tax marital deduction without proper planning.

One of the major ameliorations of the burden of U.S. gift and estate taxes is the deduction for gifts and death-time transfers to U.S. citizen spouses. Before 1998, the marital deduction had been available for transfers to a spouse regardless of citizenship. Since 1988, the gift tax marital deduction has been available only for transfers to U.S. citizen spouses, although transfers to a foreign citizen spouse of up to $110,000 can be made each year under a special variance of the gift tax annual exclusion. While persons can avoid making what would otherwise be taxable gifts or taxable bequests to a trust for a U.S. citizen spouse if the trust conforms to special requirements, such transfers cannot be made to a trust for the benefit of a foreign spouse, except for transfers upon death to a trust that meets the additional special requirements established for "qualified domestic trusts." Moreover, in this connection, there are special traps for the unwary in the area of joint gifts because the presumption that spouses owning property jointly over that property on a fifty-fifty basis does not apply to spouses of mixed citizenship. Special care must therefore be taken in acquiring property in joint name.

With respect to qualified domestic trusts, it should be noted that distributions of trust principal to a surviving spouse during the spouse's lifetime are not ordinarily immune from estate tax. Instead, all such distributions, except for certain "hardship" distributions, are taxed as additions to the taxable estate of the spouse under whose will the trust was established or with whose property the trust was funded. These limitations work a real distortion on a family's estate plan, especially because the unified credit that might have been preserved to enable children or more remote descendants to receive property free of transfer taxes must now be dedicated to the surviving spouse if it is deemed necessary or desirable to leave the surviving spouse any assets outside the trust, free of any potential liability, such as homes, retirement accounts and insurance.

VIII. There is no U.S. income tax deduction for direct gifts to foreign charities by any individual subject to U.S. income tax, but direct gifts to foreign charities by U.S. citizens and domiciliaries are eligible for the gift and estate tax charitable deductions.

In general, the United States does not permit individuals to claim an income tax deduction for direct contributions to foreign charities. The charitable income tax deduction applies to contributions to corporations, trusts or community chests, funds or foundations "created or organized in the United States or any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States." However, in a 1963 Revenue Ruling, the IRS. did allow that the deduction would be available for gifts to a domestic charity that makes grants to foreign charities for purposes the domestic charity reviews and approves or that conducts activities in a foreign country through a foreign subsidiary. In a 1966 Revenue Ruling, the IRS went further and approved the deductibility of contributions to a domestic charity that "at times solicits contributions which are used to provide grants to [a] foreign organization, for specific purposes approved by [the domestic charity's] board of directors in accordance with its bylaws." This Revenue Ruling forms the basis for deductibility of contributions to domestic charities that style themselves as "friends" or "supporters" of a foreign charity.

Generally, the limitations on contributions to foreign charities do not apply for purposes of estate taxes payable by the estates of U.S. citizens and U.S. domiciliaries and gift taxes payable by U.S. citizens and U.S. domiciliaries. The estate tax deduction is available for transfers to "any corporation" organized exclusively for charitable purposes and the gift tax deduction is available to transfers to "a corporation" organized exclusively for charitable purposes, in both cases without restriction to corporations created or organized in the United States.

The same holds true of trusts, community trust funds, chests and the like, but without the restriction that any such trust, community fund and so forth be exclusively organized for charitable purposes.

The estate and gift tax deductions, in the case of U.S. citizen and domiciliary estates or donors, are also available for transfers "to or for the use of the United States, any State, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes." Transfers to a foreign government for an exclusively public purpose are therefore not deductible. However, some transfers to foreign governmental units have qualified for transfer tax deductions on the theory that the purposes of the transfers include charitable purposes that would generally be considered appropriate for non-governmental as well as governmental entities and that the recipient of a bequest or gift, for purposes of the gift and estate tax charitable deductions need not be devoted exclusively to charitable purposes. In a 1974 Revenue Ruling, the IRS agreed to accept two decisions of the U.S. Courts of Appeals, one allowing estate tax deductions for transfers of funds to a hospital corporation owned by a Canadian municipality, and the other a coin collection to the State of Israel for permanent display in a museum. The IRS insists, however, that a bequest to a foreign government or political subdivision must be limited to exclusively charitable purposes. For example, the IRS disallowed the deduction for a contribution to a foreign country even though the foreign country agreed that the bequest would be used for an agricultural high school. In another case, the IRS disallowed the deduction for a bequest to a foreign country under whose law general bequests must be used for charitable purposes. It is clear that the bequest, by its terms, must be limited to charitable purposes and reliance on internal procedures of a foreign government or agreement between the foreign government and the estate will not remedy the deficiency.

IX. Persons who are not U.S. citizens or U.S. domiciliaries can make gifts of U.S. financial assets (other than cash) completely free of U.S. gift tax.

Foreign persons—that is, persons who are not U.S. citizens or domiciliaries—have the benefit of what is perhaps the biggest authorized "tax loophole" in the U.S. transfer tax system. Specifically, gifts by such foreign persons of all U.S. assets other than U.S. real property and tangible property located in the United States are completely free of U.S. gift tax. Some care should be taken when a foreign person makes gifts of cash intended to be used to purchase U.S. real property. In such cases, the IRS may argue that the gift is really a gift of real property subject to U.S. gift tax.

The benefit of the essential exemption from U.S. gift tax on transfers of all intangible assets by foreign persons is not only that a foreign person may make gifts of U.S. assets to family and friends—but that it is a powerful planning tool in two particular categories. First, for a foreign person with substantial U.S. assets, it makes it possible to organize the foreign person's property to avoid U.S. estate tax upon the death of the foreign person with virtually none of the tax costs that must often be incurred to effect a proper estate plan for a U.S. citizen or domiciliary. Second, for a foreign person with substantial U.S. or foreign assets who has family and friends in the United States whom such person wishes to benefit, property can be organized for the benefit of those U.S. beneficiaries in a way that will preserve the assets from U.S. transfer tax for many generations. The principal vehicle for this benefit is a long-term family or "dynasty" trust that is funded with intangible U.S. or foreign assets. An indirect benefit of there being no gift tax on transfers by foreign persons into U.S. domestic trusts of foreign assets and U.S. intangible assets is that these transfers are also completely exempt from generation-skipping transfer tax. If the property was given directly to the present generation of U.S. beneficiaries, the property would be subject to estate tax and possible generation-skipping transfer tax as long as these taxes continue to exist. By placing the property in trust for the benefit of the U.S. beneficiaries but without their holding title to the property, the property can be available to members of the U.S. family but be completely insulated from the U.S. transfer tax system.

Prior to changes in the law enacted in 1996, it was possible for foreign persons who established irrevocable foreign trusts to confer a special income tax benefit on U.S. beneficiaries by ensuring that trusts they established qualified as "foreign grantor trusts" for purposes of U.S. income tax. In this way, a foreign trust could make distributions to U.S. beneficiaries and the receipt of the distributions would not cause the U.S. beneficiaries to have U.S. taxable income. Under current law, the only irrevocable trust that would qualify for this treatment would be a trust for the benefit of a U.S. spouse of a foreign person. The same benefit can still be realized if the foreign trust making distributions to U.S. beneficiaries is fully revocable by the person who established the trust. For some foreign persons who would like to benefit U.S. persons, particularly if these foreign persons live in jurisdictions that do not have income taxes, using a revocable trust structure may merit consideration.

X. Persons who are not U.S. citizens or U.S. domiciliaries are subject to U.S. estate tax on their U.S. assets, but they can avoid U.S. estate tax on virtually all U.S. assets with proper planning.

As noted in the discussion in Part II, persons who are neither U.S. citizens nor U.S. domiciliaries who die owning U.S. assets are subject to U.S. estate tax on these assets. They also have a greatly diminished estate tax unified credit that translates into an estate tax exemption of

only Sixty Thousand Dollars.[7] However, as also mentioned above, persons who are neither U.S. citizens nor domiciliaries and who are considered nonresident aliens for U.S. income tax purposes enjoy an exemption on virtually all U.S. bank deposits and accounts and on virtually all U.S. debt instruments issued since July 1984. U.S. life insurance policies on the life of a foreign decedent are also not taxed as part of such a person's estate.

While foreign persons are not eligible for as large an authorized tax loophole in the estate tax area as they are in the gift tax area, they have the next best thing—an almost breathtakingly simple way of protecting all of their assets from U.S. estate taxation. If an entity that the United States recognizes as a foreign corporation owns U.S. assets, the United States does not look through the foreign corporation to determine whether the underlying assets are U.S. assets. This is as true of real property and tangible property located in the United States as it is of intangible property A trust does not function in this way because, under long-established statutory rules, a trust in which the grantor has retained an interest or certain forms of control cannot serve as an intermediary entity to shelter the underlying assets from tax. Whether a partnership can be used for this purpose has been uncertain for many years. Moreover, since limited liability companies are usually treated for tax purposes as partnerships, it is also uncertain whether they would insulate their underlying assets from U.S. tax unless a check-the-box election is made to treat the company as a corporation.

Sound estate planning for foreign persons therefore generally requires the use of an offshore corporate entities. In the ideal situation, U.S. assets would be acquired in the name of the corporation. Transfers of U.S. assets owned by a foreign client to an offshore corporation are the next best thing, although transfers of real property to foreign corporations have been sometimes attacked by the IRS on step transaction theories.

It should be noted that, with proper planning, it may also be possible to obtain income and capital gains tax savings for foreign clients who contemplate acquiring U.S. property or making gifts of property to U.S. persons or entities.

Conclusion

In conclusion, it is hoped that the discussion in this article has highlighted some of the novel and complex issues that must be confronted in dealing with cross-border estate planning. The article does not purport to prescribe answers to all of these issues, but hopefully it will enable readers to identify those unexpected circumstances and superficially domestic scenarios that can easily harbor international estate planning issues and challenges.

Endnotes

1. At one time, the U.S. did not attempt to impose its transfer taxes on a U.S. citizen's transfers of real property, but that exclusion was abolished in 1978. Predictions about the long-term future of the federal estate tax, now slated for a one-year suspension in 2010, are almost as numerous as the predictors. Given the vagaries of U.S. politics and the re-emergence of the federal deficit, it seems imprudent to assume that the current tax structure will be totally disassembled.
2. Keep in mind that all three countries mentioned in the previous discussion in Part III.A. about forced heirship operate under the systems of community property.
3. Care must be taken to ensure that transfers to those entities do not result in adverse income tax consequence to the client under the tax laws of the country in which the property is located or, if the client lives abroad, the country of the client's residence. In most cases, these transfers should be able to be effected without adverse U.S. income tax consequences.
4. Thus, the amount of foreign tax paid must be multiplied by a fraction, the numerator of which is the value of the property in the foreign country subject to that country's tax that is also taxed by the United States, and the denominator of which is the value of all property subject to foreign tax by that country. Take an estate of a U.S. citizen living in a foreign country that consists fifty percent of real property in the foreign country and fifty percent of a trust that the foreign country taxes but the United States does not. Only fifty percent of the tax paid to the foreign country on the real property would be available for credit against the United States tax.
5. Thus, the amount of the U.S. tax paid must be multiplied by a fraction, the numerator of which is the value of the property subject to tax in the foreign country, and the denominator which the total property subject to United States tax. For this purpose, the value of the foreign property in the numerator of the ratio must be reduced by deductions to the extent they would cause the property to be effectively excluded from U.S. tax, including the charitable and marital deductions and the special deduction allowed for taxes paid to a foreign country on charitable contributions. Similarly, the value of the entire estate subject to U.S. tax in the denominator is reduced by the marital and charitable deductions allowed on the entire estate.
6. The U.S. Treasury's final regulations provide a "safe harbor" for compliance with the "court test." Thus, a trust will be deemed to satisfy the "court test" if (1) the trust instrument does not direct that the trust be administered outside the United States, (2) the trust is administered exclusively in the United States, and (3) the trust is not subject to an automatic immigration provision. The requirement that the trust be administered in the United States means all steps necessary to carry out the terms of the trust and applicable law (including maintaining the records of the trust, filing tax returns, managing and investing trust assets, defending the trust from suits by creditors, and determining the amount and timing of distribution) must be performed in the United States.
7. The revamping of the federal transfer tax system in 2001 provided partial estate tax relief to U.S. citizens and domiciliaries by gradually raising the estate tax exemption from $1 million now to $3.5 million in 2009. No such relief was afforded to the estates of persons who are neither U.S. citizens nor U.S. domiciliaries, for whom the exemption remains at the current Sixty Thousand Dollar level.

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APPENDIX A

Basic Choice of Law Concepts for International Estate Planning

A. Choice of Law Based on a Distinction Between Real Property and Personal Property. Virtually every jurisdiction within the United States uses a relatively simple rule to determine the law that governs the property that is part of a decedent's estate. That rule says that the law of the situs of real property governs all legal issues concerning any such real property, including the land that makes up the property and the physical building and other structures that cannot be easily removed from the land. The rule also says that the law of the domicile of the decedent governs all other forms of the decedent's property, which is generally referred to as "personal property" and includes tangible property other than real property as well as all financial assets, claims and legal rights, often referred to as "intangible property."[1]

An example will help to make clear how important the distinction between real property and personal property can be in determining governing law: Take a surviving spouse whose deceased spouse was a New York domiciliary who also owned real property in Arizona and the surviving spouse received from the deceased spouse less than the amount of the elective share. The New York elective share rules should apply to all of the decedent's personal property, regardless of whether the decedent owned stock in companies outside of New York or had claims against persons or rights in businesses outside of New York, as well as the decedent's New York real property. But the surviving spouse's mandatory right to share in the Arizona real property would most likely be governed by Arizona law. Since Arizona does not confer on surviving spouses the right to claim a share of a deceased spouse's estate, the surviving spouse would have no claim in this regard against the Arizona property. However, Arizona is a community property state and, if the surviving spouse could show that the Arizona property was acquired by funds acquired by the decedent during their marriage, the surviving spouse may well be able to claim a one-half undivided share in the property on the basis that the real property was property of the marital community.

Anyone advising U.S. clients who own property abroad must be aware that most countries abroad (with the exception of some countries in the common law tradition, like England and provinces of Canada other than Quebec) do not follow the rule based on the distinction between real and personal property. First, for those countries who do make some distinction between what Americans would consider real and personal property, the distinction is made between "immoveable" and "moveable" property. The distinction is similar to the differences between real and personal property, but not the same. Generally, immovable property consists not only of land and permanent structures connected to it but also leaseholds, mortgages and other claims or rights that are closely related to real estate. Moveable property generally consists of all other forms of property including financial assets other than those closely tied to real property. Take a U.S. citizen client domiciled in New York who owns a mortgage on real property located in France. We will assume that this person is not a dual U.S.-French citizen. What law will govern the inheritance of the mortgage? France applies French law to immoveable property located in France owned by a person who is not a French citizen and applies domiciliary law to that person's moveable property. Because the mortgage is considered under French law to be immoveable property, French law would govern.

B. Choice of Law Based on a Unitary Approach to Property. The biggest differences between the way we in the United States are accustomed to determining governing law and the way governing law is determined in many other countries is (1) they do not make any distinction between types of property at all, and (2) they determine governing law in the estate context on the basis of nationality. Where the country of nationality has a federal system, the governing law would be determined on the basis of the "habitual residence" of the decedent. This appears to be a much simpler and straightforward approach. Thus, for example, a United States citizen who has lived in New York for many years and who owns real property in Germany could assume that German officials would apply New York law to the inheritance of the property because of the owner's U.S. nationality and New York residence.

Unfortunately the issue has become more complicated over recent years because many countries, including Germany, have adopted a more complicated approach to applying the law of nationality. The principle of nationality remains unchanged but now the reference to the law of nationality is not only to the property and inheritance laws of the country of nationality but also to the "choice of law" rules of that country as well. So, in our example, a German court would look first to the choice of law rules of New York before looking to the substantive New York rules. Since, under New York law, the law that applies to real property is the law of the situs or location of the property, a German court would most likely apply German law to the inheritance of German real property owned by a New York decedent. Practice in this regard among the major civil law countries in Europe is not consistent, which underscores the need for obtaining competent local counsel in dealing with most international estate planning and administration issues.

Endnote

1. Thus, interests in leaseholds, mortgages or even stock in cooperative housing corporations, since they are not direct interests in real property, are considered personal property and would be governed by the law of the domicile of the decedent rather than the law of the location of the real property to which they are related.

Doing Business in China After Its Accession to the World Trade Organization

By George A. Ribeiro

I. Introduction

China became an official member of the World Trade Organization (WTO) on 11 December 2001. Since then, new laws have been promulgated on the basis of China's commitment to accord foreign-invested enterprises (FIEs) with treatment no less favorable than that afforded to domestic enterprises in the conduct of business in China. This article discusses some of the major changes, at both the national and municipal levels, relating to the removal of the earlier prohibitions and equity level barriers placed on foreigner investors, and how business is now facilitated in China for investors with capital and experience in the relevant field.

II. Relaxation of Rules on Foreign Investment

A. Enhanced Scope of Industries Open to Foreign Investment

A set of new regulations governing the permissible areas of foreign investment took effect on 1 April 2002. On the same day, revisions to the Catalogue of Guidance on Foreign Investment Industries came into effect. These nationally applicable regulations widen the scope of industries open to foreign investment, and remove various existing restrictions.

In essence, foreign investments are classified into four categories, namely, encouraged, permitted, restricted and prohibited. Restricted industries are those where foreign investment is only allowed through joint ventures with a local party. Prohibited industries are those where foreign investment is not allowed in any form.

Prohibitions against industries such as telecommunications, construction of urban networks of water supply, gas and heat power have been lifted, and such industries have been reclassified by placing them into the restricted category. Industries that involve the use of advanced technology and are advantageous to the development of the western region are now categorized as encouraged.

B. Use of Capital

From 1 July 2002, FIEs may convert their foreign currency funds in their "foreign exchange capital accounts" maintained with designated banks approved by the State Administration of Foreign Exchange (SAFE) into Renminbi without governmental approval. Approval was previously required.

Conversion will, however, not be allowed if the Renminbi are for use outside the business scope of the FIE. Conversion of funds in accounts other than capital accounts remains subject to the approval of SAFE.

III. Specific Industries Blessed at National Level

A. Telecommunications

Previously, any form of equity participation in the telecommunications industry in China by foreign investors was prohibited. Specifically, the industry was dominated by local telecom giants.

On 1 January 2002, a new set of regulations re-defined the telecom industry into basic services such as paging, telephone, and other value-added services.

Foreign investment upon government approval in the form of an equity joint venture is now permitted. Depending upon the scale of services provided, different establishment requirements apply. For instance, a minimum start-up capital of RMB 2 billion is required for provision of basic telecom services operating on a national or cross-municipal scale, whereas capital of RMB 10 million applies to the provision of value-added telecom services operating on a national or cross-municipal scale.

To be eligible for establishment, the principal foreign and domestic investors in a basic telecom joint venture are required to bring in thirty percent of the registered capital of the joint venture. The foreign principal investor is further required to be a licensed basic telecom operator in its home country. As for value-added telecom joint ventures, such requirement does not apply.

B. Securities and Fund Management

On 1 July 2002, the green light was given to foreign participation in the securities and fund management industries in China. Participation can be in the form of acquiring stakes in existing domestic companies or establishing new joint-venture companies with domestic partners.

In relation to fund management companies, foreign investors are now allowed to own up to thirty-three percent equity, with a maximum of forty-nine percent by the end of the year 2004. Requirements include: (i) absence of a conviction for a felony or other heavy penalty by the relevant securities commission or justice departments in the past three years; and (ii) the contribution of not less than RMB 300 million as paid-in capital into the joint-venture company.

As for securities companies, foreign investors are allowed to hold up to a one-third stake, but control is to be maintained by the domestic partner. Upon the opening up of the industry, foreign investors will further be allowed to trade both A-share and B-share contracting business through domestic securities companies or by establishing securities joint ventures. In terms of requirements, apart

from being qualified in securities trading, the foreign investor must possess at least ten years of experience in the financial trading business. A good reputation and business records in the international securities market are also required.

Complementing such relaxation, the Securities Association of China (SAC) also announced the approval of membership in SAC by foreign securities companies. Prior to the announcement, membership in SAC was restricted to domestic securities, fund management and securities consulting companies. To be eligible for the newly approved membership, the applicant foreign company is required to acquire a securities trading license and be registered in China.

Further, on 24 July 2002, applications from foreign brokerages for B-share trading seats became entitled to acceptance. Instead of trading through local brokerages as agents, foreign brokerages can now trade in the B-share market directly.

Currently, the A-share market of the Exchange is open to domestic investors only. It is, however, expected that the Government will soon take the bolder step of opening up the US$500 billion market to foreign investors through a Qualified Institutional Investors Scheme.

C. Civil Aviation

Previously, foreign investment in domestic airline business had been limited to a thirty-five percent equity stake.

From 1 August 2002, foreign companies will be allowed to invest in domestic aviation companies through expanded authorized investment channels, including share purchases and capital injection. The thirty-five percent limitation of shareholding by foreign investors can be augmented to forty-nine percent. No single foreign investor can hold more than twenty-five percent, and if there is more than one foreign shareholder, their aggregate shareholding cannot exceed forty-nine percent of the total shareholding of the airline business. In terms of management, the new regulations permit that offices such as president and chief executive of an aviation joint venture can be occupied by appointment from the foreign investor.

For aviation-related joint venture ground service projects (such as cargo storage and aviation food supply)—and those joint venture projects relating to the agriculture, fisheries and forestry industries—distribution of shares of the entity will be subject to negotiation between the domestic and foreign investors. The foreign investor may thus hold a majority interest. The limitation that the controlling stake must be held by the domestic investor nonetheless remains in the areas of tourist-related air services and private and industrial air services, such as aircraft maintenance.

D. Printing

In early 2002, the Ministry of Foreign Trade and Economic Co-operation issued a new set of regulations to remove the restriction on foreign investment in the printing industry in China.

Under the regulations, wholly foreign-owned enterprises engaging in package printing are now allowed. Joint ventures engaged in publication printing, where the majority stake is held by a Chinese counterpart, are also permitted. Such joint ventures will normally be granted an operation period of not more than thirty years.

To be eligible for the above establishments, both investors must be equipped with managerial experience in the printing business. The foreign investor must bring in skills and facilities in the industry that meet global standards. In terms of required capital, foreign investors engaging in publication and package printing are expected to contribute no less than RMB 10 million, whereas those engaging in any other printing business are expected to contribute no less than RMB 5 million.

E. Insurance

Before China's accession to WTO, the insurance industry in China was restricted to local insurance companies. With effect from 1 February 2002, pursuant to the Foreign Funded Insurance Company Management Provisions, foreign-funded insurance companies, with the approval of the China Insurance Regulatory Commission, may be established in China. Once approval is obtained, they are allowed to engage in property, liability, credit, life, health and accident insurance.

Further, foreign insurers will be allowed to set up non-life insurance joint ventures in China, of which the foreign insurers can own up to fifty-one percent equity. Wholly foreign-owned non-life insurance companies will be allowed by the end of 2003. For life insurance joint ventures, the foreign insurers can own up to fifty percent equity.

Currently, insurance companies can only invest in bank deposits, inter-bank lending, treasury bonds, and various selected corporate bonds and securities investment funds. Direct investment of insurance funds into the stock market may be a possible channel of investment in future.

F. Medicine

The pharmaceutical industry, both retail and wholesale, is currently restricted to domestic investment. For decades, it had been monopolized by state-owned enterprises until its opening up to private investors recently. To date, there are approximately seventeen thousand pharmaceutical wholesalers and one hundred twenty thousand retailers authorized by the government in China.

Foreign investors may participate in the pharmaceutical industry by the end of year 2004. By then, capital or geographical constraints will be phased out. Foreign investors may apply to the relevant authority to establish a pharmaceutical joint venture, provided that the assets of the foreign investor company exceed the value of US$2 billion for the year preceding the application and its annual

turnover amounts to over US$2 billion in each of the preceding three years. Foreign investors, except in the case of wholesale joint ventures, may be allowed to hold majority stake.

The joint ventures will first be tried in key cities such as Shanghai, Guangzhou and Beijing, but it is expected that preferential treatment will be offered in the central and western regions.

IV. Municipal Level

In addition to the above new nationally applicable regulations, promising incentives have also been introduced at the municipal level, in cities such as Beijing, Shanghai and Shenzhen, to attract foreign capital while improving the investment environment.

A. Beijing

A set of guidelines in regard to foreign investment has been drawn up by the Beijing municipal government. These guidelines provide for the opening up of various industries in the tertiary sector, namely, telecommunications, transport, logistics, tourism, education, construction, commerce and environmental protection. In particular, wholly foreign-owned enterprises will now be allowed in businesses relating to real estate development, consultancy, architecture, technology and public relations. Operation of logistic businesses, supermarkets, chain stores and e-businesses is further encouraged.

B. Shanghai

The Shanghai government has announced that revisions will be made to the numerous regulations that govern application for business licenses, leading to simplified application procedures.

To further the city's efforts in improving dispute resolution, an improved and comprehensive dispute settlement system is scheduled to be established by the end of 2002, adding to the business dispute center that is currently available to foreign investors.

Development of the four main manufacturing bases, namely, the Shanghai International Auto Town, the Baoshan steel production base, the Shanghai petrochemicals manufacturing zone and the Zhangjiang integrated circuit manufacturing base in Pudong, which are all currently open to foreign investment, will be further accelerated.

C. Shenzhen

Shenzhen has announced the opening up to foreign investment of sixteen business sectors, including accounting and consultancy services. Other sectors, such as financial services, logistics and tourism, are also expected to be opened in due course.

Targeting attracting high-technology industry, Shenzhen also plans to set up a special zone at a location along the border between Hong Kong and Shenzhen. In particular, construction of the Shenzhen Software Park is scheduled to commence this summer. It is expected that the Park will bring to Shenzhen an annual sales volume of approximately US$3.6 billion and that at least eight hundred domestic and foreign software companies will be set up in the Park by the year 2005.

Wholly foreign-owned purchase centers engaged in foreign trade will also soon be allowed establishment in the city. Under the new rules, export of commodities of all types is allowed, subject to the import of materials and equipment only for production. It is also expected that these purchase centers will enjoy preferential policies, such as tax rebates for their exports. Other preferential policies, such as those relating to the use of land, are under consideration.

The Shenzhen's Bureau of Industry and Commerce has further unveiled a pilot scheme under which foreign businessmen will be allowed to set up businesses wholly owned by themselves on the mainland side of Lowu in Shenzhen (which is immediately across the border from Hong Kong), without having to abide by the conventional joint-venture rules. In the past, some businessmen had been doing business either under licenses of their relatives in China or leasing from PRC entities, which caused numerous conflicts and disputes.

Albeit the hurdle of the joint-venture model has been removed, there are still several industries where approval from the relevant government authorities must be sought before the necessary Individual Business License can be issued. For example, retailers of audio-video products, newspapers and magazines and other entertainment items must be approved by the Administration of Culture at or above the city government level, while for pharmaceutical, medical and biochemical products the application must go through the relevant Health Bureau at or above the provincial level.

V. Conclusion

The year 2002 marked a new era of foreign investment for FIEs in China. The level of announcements and new legislation at both national and municipal levels demonstrates efforts to substantiate China's commitment to opening up its market to global participation and to extending invitations to leaders in the relevant industries to invest in China with the promise of a level playing field for both domestic and foreign investors. Undoubtedly, new regulations will have to be implemented stage-by-stage, but experienced investors in new markets may well be able to surpass teething issues and become dominant players in the new China business regime.

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Liability On-Line: Choice of Law and Jurisdiction on the Internet, or Who's In Charge Here?

By Andre R. Jaglom

I. The Applicability of Multiple Laws

Use of the Internet generally, and the World Wide Web in particular, has exploded in recent years. Many thousands of companies have established "home pages" on the Web, through which they communicate advertising and marketing materials, as well as other content, to those who choose to access their sites. Often purchases and other contracts may be made directly on-line. Frequently links are provided by which browsers may be taken automatically to other sites, with materials and content provided by third parties. Many companies provide access to storehouses of information through their sites, becoming significant content providers.

These business Web sites are often (indeed, perhaps typically) established by marketing personnel with little consideration given to the legal risks that may be incurred. The Internet is a unique medium in that it is effectively borderless, providing instant global exposure for the information made available on the Web. This raises thorny questions of the applicable law governing the provider of such information. Laws in well over a hundred countries with Internet access potentially govern advertising content, consumer protection, permissible speech, defamation, intellectual property infringement and myriad other matters. Consider the following examples.

- An Italian publisher is enjoined from publishing its "PLAYMEN" magazine in the United States because it infringes the "PLAYBOY" trademark. Publication in Italy is lawful. The publisher then makes the magazine available over the Internet from a computer in Italy. A federal district court has held that conduct to violate the injunction.[1]
- Virgin Atlantic Airways, a British airline, advertises a discount airfare between Newark and London on the Internet. The U.S. Department of Transportation fined Virgin Atlantic $14,000 for failure to comply with U.S. advertising rules requiring clear disclosure of applicable taxes.[2]
- Benetton S.p.A., an Italian clothing marketer, runs an advertisement showing a human body marked "H.I.V. Positive." The ad is found to violate German law by exploiting intense "feelings of pity" and French law as a "provocative exploitation of suffering."[3] What would be the consequences of putting such an advertisement on the Web?
- A major French catalog company decides to put its catalog on the Web. Some fifty pages of the catalog sell lingerie, with photographs designed to appeal to the French buyer. What repercussions might there be from the availability of this catalog in fundamentalist Islamic countries? What should counsel advise the company President before his next business trip to Singapore or Iran?[4]
- The French Evin Act of 10 January 1991 forbids all "advertising and direct or indirect promotion" regarding tobacco and, in certain circumstances, alcohol. The French TOUBON law of 4 August 1994 requires that businesses offer their products and services to consumers in the French language.[5] What are the consequences of these laws for Web sites located outside France but accessible there?

II. Jurisdictional Questions

These not so hypothetical situations raise obvious jurisdictional questions. Put aside for the moment the questions of whether foreign countries would apply concepts of jurisdiction similar to those familiar to U.S. counsel, or in the case of some countries would even concern themselves with niceties of jurisdiction. (The capital sentence levied *in absentia* by ayatollahs in Iran on author Salman Rushdie for publication abroad of the allegedly blasphemous *Satanic Verses* suggests that at least some nations would have no difficulty with penalizing conduct on the Web.)

Under U.S. law one might argue that the availability of a passive Web site within a state is insufficient to confer jurisdiction over the operator of the site in that state, at least in the absence of evidence that the site operator purposefully availed itself of the benefits of that state or continuously and systematically conducted part of its general business there. That, indeed, was the holding in *Digital Control Inc. v. Boretronics*,[6] *Mink v. AAAA Development LLC*,[7] *Cybersell Inc. v. Cybersell Inc.*[8] and *Bensusan Restaurant Corp. v. King and the Blue Note*,[9] among others.[10] That argument, however, might fail for a national or multinational corporation that does intend its site to be viewed globally.

Many courts have disagreed with the *Bensusan Restaurant* line of holdings. *Inset Systems, Inc. v. Instruction Set Inc.*[11] held that a Massachusetts corporation was subject to jurisdiction in Connecticut by reason of its advertising on a Web site available for viewing in Connecticut, thus "purposefully avail[ing] itself of the privilege of doing business within Connecticut." *CoolSavings.com Inc. v. IQ Commerce Corp.*[12] held that establishing a Web site accessible to all states constitutes

purposeful establishment of minimum contacts with all states.[13] *National Football League v. Miller*,[14] while purporting to follow *Bensusan*, held that the operator of a passive Web site was subject to jurisdiction in New York because he profited from sales in interstate commerce of advertising on the Web site, which caused harm to the plaintiffs to New York and was viewed by many New Yorkers.

Other cases have upheld jurisdiction based on forum state activities beyond mere Web site accessibility, such as advertising in forum state media, sales of passwords or services to forum state residents, contracting for forum state access with Internet service providers, explicit on-line solicitations and some level of interactivity or information gathering.[15]

The jurisdictional standard of purposefully availing oneself of the privilege of doing business in a state is met, for purposes of claims arising from the defendant's activities in a state, where there are numerous transactions with residents of the state. Thus where a domain name registrar was alleged to have engaged in some 5,000 transactions with Ohio residents and its site was accessible in Ohio, the Sixth Circuit held in *Bird v. Parsons*[16] that it was subject to its jurisdiction in a trademark infringement suit, since the infringement arose from the registration business.[17] The D.C. Circuit similarly found jurisdiction over a defendant whose Web site allowed Washington, D.C. residents to form contracts with it to buy securities and brokerage services in *Gorman v. Ameritrade Holding Corp.*[18] The Court distinguished *GTE New Media Services Inc. v. BellSouth Corp.*,[19] where a yellow pages Web site was "essentially passive," allowing customers to obtain information, but not to contract with the defendants.

A growing number of cases have followed *Zippo Manufacturing Co. v. Zippo Dot Com Inc.*, [20] which developed a relatively simple active/passive test for determining jurisdiction over a Web site operator.[21] Web sites are categorized on a spectrum from purely passive sites that merely make information available to visitors, which do not alone provide a basis for jurisdiction, through levels of increasing interactivity to full e-commerce sites that permit on-line contracts and transactions with forum residents, which do suffice as a jurisdictional basis in the forum. The more interactive the site, the more likely jurisdiction is to be found.

Similarly, consider *United States v. Thomas*,[22] affirming the *criminal* conviction on obscenity charges in federal court in Tennessee of a California couple who sold sexually explicit photographs by making them available for downloading from a computer bulletin board in California. The offending materials were downloaded in Tennessee by a United States Postal Inspector acting on the complaint of a Tennessee resident. The defendants argued that venue in Tennessee was improper because they did not cause the files to be transmitted to Tennessee. That was done by the zealous postal inspector. The Sixth Circuit held otherwise, finding substantial evidence that the defendants set up their bulletin board so that persons in other jurisdictions could access it.[23] The Sixth Circuit therefore held not only that venue in Tennessee was proper, but that the appropriate community standards to be applied in determining whether the materials were obscene were those of Tennessee.[24]

Such state jurisdictional issues are relevant to the regulation of "spam" (unsolicited commercial e-mail) and several states[25] have passed laws regulating spam received by their residents, regardless of its place of origin. While some state statutes regulating spam have been struck down as violative of the commerce clause of the U.S. Constitution,[26] others have been upheld.[27] The European Community is also moving toward legislation on this issue.[28]

Across the Atlantic, German prosecutors indicted the general manager of Compuserve's German operation on charges of trafficking in pornography because it provided Internet access to its customers without blocking independent child pornography sites, as well as failing to block sites with Nazi and neo-Nazi material, which are illegal in Germany.[29] After conviction, he was given a two-year suspended prison sentence and fined.[30] The guilty verdict was finally overturned in November 1999, based on a new multimedia law enacted after the conviction.[31] The incident nonetheless suggests the risks of non-compliance with foreign law.

In France, a court held it had jurisdiction to hear a trademark case brought by a French trademark owner alleging infringement by a U.S.-based Internet site.[32] The French courts have also asserted jurisdiction over Yahoo! Inc., a California-based Internet company, as a result of various Nazi items offered on Yahoo!'s auction site, which was accessible by users in France, in contravention of French law[33] prohibiting the display or sale of racist material. [34] The presiding judge ordered Yahoo! to block French users from viewing Nazi memorabilia.[35] However, in a later decision he declined to go so far as to impose an obligation upon Internet service providers to block access to racist material.[36] The *Yahoo!* ruling was upheld on appeal,[37] and generated significant concern over the repercussions that such a decision, which would allow one country to regulate access to sites originating elsewhere, would have on the entire Internet. (An April 2002 European Parliament vote opposing such blocking of Web site content in favor of self-regulation by Internet service providers may limit such orders in the future.[38] But despite the Parliament vote, Deutsche Bahn AG has moved against Internet search engines Google, Yahoo and Alta Vista, seeking the removal of links to sites of extremist groups with information on rail sabotage.[39])

To the relief of some Internet companies, a U.S. District Court ruled that under the First Amendment the French court's order and fines were not enforceable against Yahoo! in the United States.[40] Yahoo!'s international division senior corporate counsel believes that this decision renders the French decision meaningless[41] and affords First Amendment protection to content hosted at U.S. based Web sites.[42] Others believe the French judge's attempt to restrict Nazi memorabilia on Yahoo! may be a harbinger of the Internet of the future where geolocation techniques determine which sites a viewer may enter based on the laws of and restrictions imposed by the country, state or even city from which such viewer is surfing the Internet.[43] And if Yahoo! had substantial assets in France, the daily fine levied on Yahoo! by the French court for failure to comply with its order might well be meaningful. Moreover, even in the U.S., there are efforts to require blocking of unacceptable Web sites, as evidenced by a Pennsylvania statute requiring Internet service providers to block access by Pennsylvania residents to Web sites containing child pornography or face criminal penalties.[44]

The French Yahoo! decision is by no means unique. A Milan appeals court's recent ruling on a defamation claim follows the same logic. The court ruled that a defamation claim against a site created in Israel was prosecutable despite Italian case law disallowing the prosecution of defamation that originates outside of Italy. The Milan court distinguished the case by citing the fact that Italian Internet users needed Italy-based service to view offending pages.[45] Likewise, Australia's Victoria Supreme Court has ruled that an article containing allegedly defaming material which originated in New Jersey was also "published" in Melbourne via the Web and therefore a defamation suit based on the article could properly be brought under Australia's strict defamation laws.[46] This Australian ruling would create liability for on-line publishers anywhere their material is read, or at least wherever a potential victim might be found.

A recent federal district court decision is to the contrary, holding that a passive Web site for offshore gambling fans that allegedly defamed a Pennsylvania resident was not subject to jurisdiction in Pennsylvania, because it had not intentionally aimed its tortious conduct at the forum state. The Court held, "There is difference between tortious conduct targeted at a forum resident and tortious conduct expressly aimed at the forum. Were the former sufficient, a Pennsylvania resident could hale into court in Pennsylvania anyone who injured him by an international tortious act committed anywhere.[47]

Finally, a 1996 article in the *New York Times* noted that "[t]here are few patches of legal turf the states guard more fiercely than gambling."[48] The article noted the problem of regulating Web sites that offer wagering over the Internet without regard to the location of the gambler. The state of Minnesota sued a Las Vegas-based company that offered sports betting on-line, contending that the company committed consumer fraud in asserting that its service was legal, as it may have been in Nevada. The issue, once more, was whose law governs a Web site in one jurisdiction that may be accessed from every other jurisdiction in the world. A Minnesota court resolved the jurisdictional issue in the state's favor, holding that advertising on a Web site available in Minnesota was sufficient to confer jurisdiction over the defendants, particularly in light of the maintenance of a toll-free telephone number and a mailing list that included Minnesota residents.[49]

A similar case was brought by federal prosecutors in New York against the owners and managers of six offshore Internet gambling sites. The sites were licensed by the governors of the Caribbean and Central American countries where they were based, raising similar issues of jurisdiction and choice of law.[50] In 1999, a New York court granted injunctive relief against one such operator, finding a violation of law despite the fact that a user of the gambling site who gave a New York address was not permitted to gamble.[51] The court granted relief, reasoning that the restriction could easily be circumvented by a New Yorker who provided an address in Nevada or other state where gambling was legal.[52]

Similar issues arise as the SEC considers how to regulate offerings of securities by foreign Web sites.[53] Currently, the SEC will not consider an offshore (non-U.S.) Internet offer as targeted at the U.S. and will not treat it as occurring in the U.S. for registration purposes if the offerors take adequate measures to prevent U.S. persons from participating.[54] Australia and Japan have similar rules and have published guidelines offerors can follow, including a jurisdictional disclaimer, to avoid violating their securities laws.[55]

International policy makers from fifty-two member nations have been trying to set common rules governing on-line trade and commerce for ten years through the Hague Convention on Jurisdiction and Foreign Judgments. As it is currently drafted, the Hague treaty would require participants to enforce each others' commercial laws even if such laws prohibit actions that are legal under local laws.[56] There are many critics in the United States who fear that U.S. citizens will lose many of their rights if all Web sites are forced to comply with the laws of every member nation. On the other hand, the software, movie and recording industries, along with other copyright holders, view the treaty as an effective means of enforcing copyright violations abroad.[57] Although it has been involved in the drafting process, it remains to be seen whether the U.S. will sign on to the finished product.

III. Determining Applicable Law

As the law in this area was developing, some commentators argued that the reasonable solution to such problems was to apply to those making information available on the Internet the law of the jurisdiction where the server is located.[58] The theory behind this thinking was that, like a library in the same location, an Internet service is a passive instrument which must be intentionally accessed by the user. Such a user may therefore violate the law of his country by visiting the library and returning with information that is unobjectionable in the library's jurisdiction but illegal in his homeland, but the library should not be subject to penalty.

Equally, the user in Iran who downloads photographs of Miss March from the Playboy Internet site may be subject to harsh penalties by the conservative judiciary in Tehran, but Playboy should not be. It is the user in Iran, goes the argument, not Playboy, which never entered or acted in Iran, who has violated Taliban law. The only difference is that the library visit is physical and the Web access electronic.

Unfortunately, this approach, while perhaps logical, depended for implementation on nations willingly forgoing jurisdiction over conduct that reaches their citizens at home and at a minimum, facilitates the violation of their laws and, often, their core religious or moral standards.

While the law, both internationally and domestically, continues to develop on jurisdiction over Web sites, such a voluntary limitation of jurisdiction is unlikely for now, as evidenced by the *Maritz* decision and the *Thomas* conviction, where even the United States judicial system found jurisdiction to hold liable, or even convict, foreign service operators who simply made offending materials available via Internet or telephone access. The German Compuserve indictment is in the same sense.[59]

In a case presenting the other side of this coin, a federal court in New Jersey recently rejected the notion that the server's location should be determinative, holding that the mere physical presence of a Web server in a particular state does not in itself provide sufficient contacts to create jurisdiction of that state over the Web site.[60]

The Electronic Commerce Directive, a regulatory framework for e-commerce, was put forth by the European Union in 2000.[61] The E-Commerce Directive does employ a "country of origin" approach when determining which country has jurisdiction over ISPs, thereby making the country in which an "information society service provider" maintains a fixed establishment, regardless of where the Web site or server is located, responsible for exercising control over the service provider and the country whose law will govern in the absence of agreement to the contrary.[62] The country-of-origin principle, however, does not apply to consumer transaction contracts.[63] Consumers remain protected by the laws of their own nation.[64] (The Brussels Regulation, which is binding in Member States without the need of implementing legislation, provides jurisdiction in a consumer's home country over a foreign defendant that "pursues commercial or professional activities in . . . the consumer's domicile or, by any means, directs such activity to that Member State . . . and the contract falls within the scope of such activities."[65])

The European Union has been active in attempting to resolve cross-border electronic commerce issues. The E.U. Commission has issued a draft regulation, to govern jurisdictional issues surrounding cross-border consumer e-transactions.[66] This proposed regulation, termed Rome II, will create jurisdiction over on-line sellers in the home state of the purchaser, a concept which is at odds with the principles of the E-Commerce Directive. The International Chamber of Commerce, among others, has called on the European Union to reconsider Rome II in favor of a regulation that would make the laws of the country of origin of goods or services the basis for settling disputes arising out of e-business transactions.[67]

Moreover, a company that sells over the Internet increasingly must consider not only the jurisdictional issues discussed above, but also various international legislative requirements with regard to how the contract is executed and performed. For instance, the recently enacted European Union Electronic Commerce Directive requires that any promotional offers or commercial communications be "clearly identified as such," that the identity of the sender is clearly identifiable, and that the offers or communications clearly and unambiguously disclose any conditions of participation.[68]

This Directive also grants the same legal validity to documents electronically signed as for their handwritten signed counterparts, provided that the electronic signature employs a reliable process of identification, guaranteeing a link between a document and the signature attached to it.[69]

The United States has similar legislation embodied in the E-SIGN Act, which gives equal force to e-signatures and signed papers, but requires that any electronic sale inform consumers of their right (i) to receive the information in paper form; (ii) to withdraw their consent to the transaction and any conditions, consequences, and fees of such withdrawal; and (iii) a description of the hardware and software required to access the electronic records.[70] In addition, thirty-eight states have adopted, and four more have pending legislation to adopt, the Uniform Electronic Transactions Act (UETA),[71] whose main purpose is to establish the legal equivalence of electronic records and signatures with paper writings and manually-signed signatures, removing barriers to electronic commerce.[72] UETA has been so widely accepted among the states in part because the E-SIGN Act pre-

empts state laws affecting electronic signatures, making an exception only when a state has adopted UETA in the form it was proposed.[73]

The United Nations Commission on International Trade has, since 1996, been developing a Model Law on Electronic Commerce. If adopted, the Model Law is not expected to have a significant impact on most developed countries, including Japan, the United States and the European Union's Member States, which have largely enacted electronic signature legislation. However, some commentators have pointed out that the U.N.'s Model Law is nothing like the electronic signature laws passed in either Europe or the United States and the effects, if adopted, will be unpredictable and sweeping.[74]

Thus, for now, the applicable maxim is plainly *communicator emptor*. At a minimum, companies establishing Web sites need to consider the legal implications of their sites, if not in every state and country in the world, at least in those in which they conduct significant business. In order to protect themselves fully, companies which are not in fact engaged in national or global business should consider placing on their sites a disclaimer of any intent to solicit business, or even site visitors, from outside specified jurisdictions. This is particularly important in light of the developing trend in the United States that a state's jurisdiction over a particular Web site is conferred through actual transactions in the state.[75]

State securities regulators have endorsed this approach from the securities law standpoint, exempting offerings that disclaim offering to residents of specific states, provided the offering is not directed at state residents by other means and sales are not made in the state.[76] Similarly, in a series of three no-action letters, the SEC permitted Web sites to screen investors by way of an accreditation questionnaire and issuing passwords to those found to be qualified. Only after reviewing the password would the investor actually access the Web site and view corporate offerings. This process was found not be a "general solicitation" in violation of Rule 507.[77]

Franchise regulations have taken a similar approach. The North American Securities Administrators Association (NASAA) adopted a "Statement of Policy Regarding Offers of Franchises on the Internet" on 3 May 1998, which deems franchise offers on the Internet as exempt from franchise registration and disclosure statutes in states where the offer indicates that it is not being made to residents of the state, it is not otherwise directed at residents of the state, and no franchise sales are made in the state before compliance with the state's franchise registration and disclosure law. This approach has since been adopted in seven states, including Indiana,[78] Maryland[79] and New York.[80] Such a disclaimer approach is doubtless anathema to Web site designers and marketing staff, but (if the disclaimer is not contradicted by the facts) at least provides an argument that the company is not "purposely availing itself" of the privilege of conducting activities in unexpected places and so should not be held subject to jurisdiction there.

The NASAA is also preparing to issue a statement of policy regarding franchise advertising on the Internet. The NASAA's proposed Internet Advertising Statement provides that any communication about a franchise offering made through the Internet should be exempted from franchise filing requirements[81] if the franchisor provides the URL of the advertising to the state franchise administrator.[82]

The United Kingdom has enacted the Consumer Protection (Distance Selling) Regulations 2000, which offer similar protection. Specifically, prospective purchasers must be provided with the name and address of the supplier; a description of the goods and services; the price for the goods, including tax; arrangements for payment, delivery and performance; and the ability of the purchaser to cancel the contract.[83]

Endnotes

1. *Playboy Enterprises Inc. v. Chuckleberry Publishing Inc.*, No. 79 CIV 3525 (SAS) (S.D.N.Y. 16 July 1996), *reported in* 52 Pat. Trademark & Copyright J. (BNA) 361 (1 Aug. 1996).
2. Rose & Feldman, *Practical Suggestions for International Advertising and Promotions on the "Net,"* Cyberspace Law. at 8 (May 1996).
3. *Id.* at 9.
4. Bertrand, *Collective Administration of Copyrights, Artists Rights and the Law of Publicity on the Internet: Current Issues and Future Perspectives*, 3 New York State Bar Association International Law and Practice Section Fall Meeting 1227 (1996).
5. *Id*. at 9. In part due to objections from the European Commission, these laws not have been construed not to apply to broadcasts from abroad of World Cup soccer games and similar sporting events that include otherwise-forbidden advertising, which are rebroadcast in France without control over content, nor to advertising legally broadcast from abroad by companies not resident in France. *Id.* In the absence of such international constraints and resulting narrow construction, however, similar laws could obviously have a major impact on Web site operators. A suit was filed against the Georgia Institute of Technology by private plaintiffs complaining that the English language Web site set up by Georgia Tech's French campus in Metz () violated French law. The case was dismissed in June 1997 on procedural grounds because the plaintiff groups failed to file a police complaint before suing, leaving unresolved the larger substantive issue. *French Purists Lose Their Cases*, N.Y. Times, 10 June 1997.
6. 2001 U.S. Dist. LEXIS 14600 (rejecting the passive/active test set forth in *Zippo Mfg. Co. v. Zippo Dot Com Inc.*, 952 F. Supp. 1119 (W.D. Pa. 1997), the court ruled that "until the advertiser is actually faced with and makes the choice to dive into a particular forum, the mere existence of a worldwide web site, regardless of whether the site is active or passive, is an insufficient basis on which to find that the advertiser has purposely directed its activities at residents of the forum state.").
7. 190 F.3d 333 (5th Cir. 1999).
8. 130 F.3d 414 (9th Cir. 1997).
9. 937 F. Supp. 295 (S.D.N.Y. 1996). The Second Circuit affirmed *Bensusan* on other grounds, namely, that New York law is narrower in its assertion of personal jurisdiction than the U.S. Constitution permits. *Bensusan Restaurant Corp. v. King*, 126 F.3d 25 (2d Cir.

1997). New York law "reaches only tortious acts performed by a defendant who was physically present in New York when he performed the wrongful act"' and would not even reach "a New Jersey domiciliary [who was] to launch a bazooka across the Hudson at Grant's tomb . . . in an action by an injured New York plaintiff," or tortious acts committed outside New York by persons who derive substantial revenues from interstate commerce. In *Bensusan*, neither was the case, but this narrower holding offers less comfort to Internet marketers.

10. *See also, e.g., Wildfire Communications, Inc. v. Grapevine, Inc.*, No. 00-CV-12004-GAO (D. Mass. 28 Sept. 2001) (the existence of a Web site accessible by Massachusetts citizens countered by a lack of actual purchases by Massachusetts customers is not sufficient to subject an out of state Web site to jurisdiction in Massachusetts); *Perry v. RightOn.com* (D. Or. 2000); *Northern Lights Technology, Inc. v. Northern Lights Club* (D. Mass. 2000); *K.C.F.C. v. Nash*, 49 U.S.P.Q.2d (BNA) 1584, 1998 U.S. Dist. LEXIS 18464 (S.D.N.Y. 24 Nov 1998), *reported in* 57 Pat. Trademark & Copyright J. (BNA) 136 (17 Dec. 1998); *Hearst Corp. v. Goldberger*, 1997 U.S. Dist LEXIS 2065, 1997 WL 97097 (S.D.N.Y. 1997).

11. 937 F. Supp. 161 (D. Conn. 1996).

12. 53 F. Supp. 2d 1000 (N.D. Ill. 1999).

13. *See also Remsburg v. Docusearch Inc.*, 2002 WL 130952, 2002 DNH 35 (D. N. H. 2002) (five transactions with New Hampshire resident by which he obtained information used to murder victim, plus a pretextual call to victim by defendant to obtain requested information, were sufficient for jurisdiction over defendant in wrongful death action). *See also Haelan Products, Inc. v. Beso Biological Research, Inc.*, 43 U.S.P.Q.2d (BNA) 1672, 1997 U.S. Dist. LEXIS 10565 (E.D. La. 1997) (Web site, plus 800 telephone number and advertisements in nationally circulated publications sufficient to consider jurisdiction).

14. 54 U.S.P.Q. 2d 1574 (S.D.N.Y. 2000).

15. *See, e.g., National Collegiate Athletic Ass'n v. BBF Int'l*, No. 01-422-A, 2001 U.S. Dist. LEXIS 11774 (E.D. Va. 4 May 2001), reported in World Internet L. Rep. (BNA) June 2001, at 23 (in ruling on a domain name dispute, Virginia court exercised jurisdiction over defendant Haitian entity which marketed its gambling Web sites in Virginia and entered contracts with Virginia residents); *Starmedia Network Inc. v. Star Media Inc.*, S.D.N.Y., No. 00 CIV 4647 (23 April 2001), reported in 62 Pat. Trademark & Copyright J. 153 (BNA) (11 May 2001), at 41 (New York long arm statute reached Washington state defendant that operated a Web site serving a national market even though the Web site had no New York customers, but did have potential business in New York); *Internet Doorway Inc. v. Parks,* Civil Action No. 3:00CV405BN, U.S. Dist. Ct. (S.D. Miss. 9 April 2001), reported in World Internet L. Rep. (BNA) June 2001, at 20 (the action of sending an e-mail message to a Mississippi resident established the necessary minimum contacts to exercise specific personal jurisdiction over such sender in Mississippi); *Ty Inc. v. Baby Me Inc.*, N.D. Ill., No. 00 C 6016 (6 Apr. 2001), reported in 62 Pat. Trademark & Copyright J. 153 (BNA) (11 May 2001), at 40 (sale of three plush toys to Illinois resident through defendant's Web site subjected Hawaiian defendant to jurisdiction in Illinois); *Kollmorgen Corp. v. Yaskawa Electric Corp.*, No. 99-308-R (W.D. Va. 13 Dec. 1999) (subsidiary's Web site conveying impression parent and subsidiary acted in consort to place goods in stream of commerce was enough to establish jurisdiction over parent); *American Network, Inc. v. Access America/Connect Atlanta, Inc.*, 975 F. Supp. 494 (S.D.N.Y. 1997); *Digital Equipment Corp. v. Altavista Technology Inc.*, 960 F. Supp. 456 (D. Mass. 1997); *Rubbercraft Corp. of California v. Rubbercraft, Inc.*, No. 97-4070-WDK (C.D. Cal. 17 Dec. 1997), *reported in* 55 Pat. Trademark & Copyright J. (BNA) 358 (26 Feb. 1998) (Web site, toll-free telephone number, advertising in national media and significant income from sales in forum state supports personal jurisdiction); *Maritz Inc. v. CyberGold Inc.*, 947 F. Supp. 1328 (E.D. Mo. 1996), (operation of a California Web site that asked customers to add their addresses to targeted e-mail addressing system constituted "active solicitation" sufficient to satisfy the "minimum contacts" requirement for jurisdiction in Missouri; and defendant was found to be "purposely avail[ing] itself" of privilege of conducting activities in Missouri); *Heroes Inc. v. Heroes Foundation*, 958 F. Supp. 1 (D. D.C. 1996); *EDIAS Software Int'l LLC v. BASIS Int'l Ltd.*, 947 F. Supp. 413 (D. Ariz. 1996).

16. 289 F.3d 865 (6th Cir. 2002).

17. *See also Neogen Corp. v. Neo Gen Screening, Inc.*, 282 F.3d 883 (6th Cir. 2002) (passive Web site available in Michigan, that also let Michigan residents use passwords to view blood test results, with at least fourteen transactions with Michigan residents, constituted purposeful availment sufficient for jurisdiction; citing *Zippo Mfg. Co*, *infra*).

18. 293 F.3d 506 (D.C. Cir. 2002).

19. 199 F.3d 1342 (D.C. Cir. 2000).

20. 952 F. Supp. 1119 (W.D. Pa. 1997) (developing the active/passive test, which gave the court the power to exercise jurisdiction over an extra-jurisdictional Web site operator if the Web site was an interactive site, but not if it was a passive site that merely provided information). *See, e.g., ALS Scan Inc. v. Digital Service Consultants Inc.* 293 F.3d 707 (4th Cir. 2002); *Neogen Corp., supra*; *Euromarket Designs, Inc. v. Crate & Barrel Ltd.*, 96 F. Supp. 2d 824 (N.D. Ill. 2000); *Search Force, Inc. v. Dataforce Int'l, Inc.*, 112 F. Supp. 2d 771 (S.D. Ind. 2000); *Blumenthal v. Drudge*, 992 F. Supp. 44 (D.D.C. 1998) (Web site providing political gossip and rumor and providing for e-mail communications and e-mail subscriptions, was interactive and subject to jurisdiction in the District of Columbia).

21. This approach has been criticized by some courts, and a few have rejected this approach in favor of the reasoning of *American Information Corp. v. American Infometrics, Inc.*, 139 F. Supp. 2d 696 (D. Md. 2001), which applied a "targeting-based" test that asks whether the defendant's actions were aimed at the forum state to determine if jurisdiction was proper. *See, e.g., Ottenheimer Publishers, Inc. v. Playmore, Inc.*, 158 F. Supp. 2d 649 (D. Md. 13 Aug. 2001); *Starmedia Network, Inc. v. Star Media, Inc.* 2001 WL 417118 (S.D.N.Y. 23 April 2001). The majority of courts, however, seem to follow the *Zippo* active/passive analysis.

22. 74 F.3d 701 (6th Cir. 1996).

23. In addition, the court found the defendants to have specifically approved the distribution of offending materials to a Tennessee resident by calling the postal inspector in Tennessee in response to a message he left at their bulletin board and providing him with an account number to use in accessing their service. The tenor of the Sixth Circuit's opinion suggests that this fact may not have been dispositive, but it certainly provides a greater degree of intentional contact with the forum than the pure establishment of a Web site accessed by others with no direct interaction with the site operator, as was the situation in the *Maritz* case.

24. *Id.* at 709-11.

25. *See, e.g.*, Cal. Bus. Profs. Code § 17538.4; Colo. Rev. Stat. § 6-2.5-101; Del. Code Ann., tit. 11, §§ 937-938; Idaho Code § 48-603E; 815 Ill. Comp. Stat. 511; Iowa Code §§ 714E.1-.2; Nev. Rev. Stat. Ann. §§ 41.705-.735; R.I. Gen. Laws, § 11-52-1; Tenn. Code Ann. §§ 47-18-1602, -2501; Wash. Rev. Code, tit. 19, Chap. 19.190. For a summary of the laws regulating spam in each state s*ee* http://www.spamlaws.com/state/index.html. As of 1 Dec. 2002, no federal anti-spam legislation had been passed, although there were several bills pending, *see* http://www.spamlaws.com/federal/index.html. *See also* Olsen, *Congress, critics wrinkle noses at spam bills,* CNET News.com (21 May 2001) located at http://news.cnet.com/news/0-1005-200-5976585.html (no effective federal spam legislation is expected to be approved any time soon). *But see Protecting Consumers' Privacy: 2002 and Beyond: Remarks of FTC Chairman Timothy J. Muris*, at The Privacy 2001 Conference, 4 Oct. 2001, located at http://www.ftc.gov/speeches/muris/privisp1002.htm (containing announcement by FTC Chairman that in 2002 the FTC will be intensifying its efforts against fraudulent spam).

26. *See, e.g.*, *American Libraries Ass'n v. Pataki*, 969 F. Supp. 160 (S.D.N.Y. 1997). *See also* discussion in Kaplan, *In Spam Case, Another Defeat for State Internet Laws,* Cyber L.J., 24 March 2000 (New York, Michigan and New Mexico anti-spam laws have been struck down either in state or federal court for violating the commerce clause of the U.S. Constitution).

27. *See, e.g.*, *State v. Heckel,* 143 Wash. 2d 824, 24 P. 3d 404 (7 June 2001) (holding law which "prohibits e-mail solicitors from using misleading information in the subject line or transmission path of any commercial e-mail message sent to Washington residents or from a computer located in Washington does not violate the dormant Commerce Clause"), *rev'g* No. 98-2-25490 (Wash. Super. Ct. 10 Mar. 2000), *cert. denied*, 122 S. Ct. 467 (Oct. 29, 2001); *Ferguson v. Friendfinders, Inc.,* __ Cal. App. 4th Supp. __, 2002 WL 4706 (Cal. App. 1st Dist. Super. Ct. 2 Jan. 2002) (holding law regulating e-mail users who send spam to California residents via equipment located in California does not violate dormant Commerce Clause), *rev'g* No. 307309 (Cal. Super. Ct. 2 June 2000). *See also eBay, Inc. v. Bidder's Edge, Inc.,* 100 F. Supp. 2d 1058 (N.D. Cal. 2000) (applying logic behind spamming case law to protect database owner from dimished server capacity caused by repeated, unauthorized intrusions by bots, i.e., smart software, intelligent agents or robots, used to locate, retrieve, copy and aggregate data that otherwise is entitled to limited or no copyright protection).

28. The European Parliament approved proposals that would allow unrestricted Internet marketing by leaving it to the Member States to regulate spam through an "opt-out" system, which is at odds with the position of the European Commission. The European Commission favors an "opt-in" system under which e-mail marketing and advertising could be lawfully sent only if a consumer has contacted a company for information. Eleven countries support the European Commission and favor a ban on unsolicited e-mail, while four, Britain, Ireland, Luxembourg and France, prefer the opt-out approach. *See* Meller, *European Confrontation Over Privacy Rights on the Internet*, N.Y. Times on the Web, 30 Nov. 2001, available at http://www.nytimes.com/2001/11/30/technology/30DATA.html.

29. *Germany Charges Compuserve Manager*, N.Y. Times, 10 April 1997, at D19

30. *Morning Briefcase*, Dallas Morning News, 29 May 1998, at 2D, *cited in* Swire, *Of Elephants, Mice and Privacy: International Choice of Law and the Internet*, 32 Int'l Law. 991, 992 n.5 (1998).

31. *German Court Overturns Pornography Ruling Against Compuserve*, N.Y. Times, 18 Nov. 1999, at C4.

32. *Saint-Tropez Commune v. SA Eurovirtuel*, *reported in* 53 INTA Bulletin No. 3, 1 Feb. 1998, at 2.

33. Section R645-1 of the French Criminal Code.

34. *Association Union des Etudiants Juifs de France et al. v. Yahoo! Inc.*, *reported in* World Internet L. Rep. (BNA) (7/00).

35. *Judge leaves screening of racist material to French ISPs*, 31 Oct. 2001, available at www.ananova.com/news/story/sm_437656.html.

36. *ISPs Not Obligated to Block Access to Hate Portal: Action Internationale pour la Justice, La Licra et al. v. Association Franchaise d'Acces et de Services Internet et al.*, *reported in* World Internet L. Rep. (BNA) (Dec. 2001). Similarly, on 27 July 2001, a German court ruled that a German Internet domain registry was not responsible for Web content, but rather the party seeking action against a Web site must address the owner of the site. *See Registry Not Responsible For Web Content*, *reported in* Case Reports (BNA) Oct. 2001, at 20.

37. Tagliabue, *French Uphold Ruling Against Yahoo on Nazi Sites,* N.Y. Times, 21 Nov. 2000, at C8.

38. Richardson, *Europe Elbows Internet Content Blocking*, The Register (11/4/2002); www.theregister.co.uk/content/6/24808.html.

39. Evers, *German Railway Operator to Sue Google over Sabotage Links*, Computerworld (4/16/2002), www.computerworld.com/story/ba/0.4125.NAV47_STO70203.00.html.

40. *Yahoo! Inc. v. La Ligue Contre Le Racisme Et l'Antisemitisme*, 169 F. Supp. 2d 1181 (N.D. Cal. 2001).

41. Kaplan, *Was the French Ruling on Yahoo Such a Victory After All?*, N.Y. Times on the Web 11 Nov. 2001 available at www.nytimes.com/2001/11/16/technology/16CYBERLAW.html.

42. Guernsey, *Court Says France Can't Censor Yahoo Site*, N.Y. Times, 9 Nov. 2001, at C5.

43. Guernsey, *Welcome to the Web. Passport, Please?*, N.Y. Times, 15 March 2001, at G1.

44. PA crimes code, 18 Pa. C.S. § 7330, Internet Child Pornography.

45. *Controlling Access to Foreign web sites: In re Dulberg*, World Internet L. Rep. (BNA), Feb. 2001, at 14.

46. Crawford and Keenan, *Court Ruling " threatens free internet*," Australian IT, 29 Aug. 2001.

47. *English Sports Betting Inc. v. Tostigan*, 2002 WL 461492 (E.D. Pa. 2002).

48. J. Sterngold, *A One-Armed Bandit Makes a House Call*, N.Y. Times, 28 Oct. 1996, at D1, col. 2.

49. *Minnesota v. Granite Gate Resorts, Inc.*, No. C6-95-7227, 1996 WL 767431 (Minn. Dist. Ct., County of Ramsey 2d Jud. Dist., 10 Dec. 1996).

50. *14 Charged by U.S. In First Such Case On Internet Betting*, N.Y. Times, 5 March 1998, at A1, col. 8.

51. *See United States v. Cohen,* No. 00-1574 (2d Cir. 31 July 2001) (court upheld conviction of founder of World Sports Exchange under the Wire Wager Act, 18 USC § 1084).

52. *New York v. World Interactive Gaming Corp.*, 1999 N.Y. Misc. Lexis 425 (22 July 1999). Jurisdiction was clear in *World Interactive Gaming*, because the defendants had many other jurisdictional contacts in New York. The decisions in *World Interactive Gaming*, and *Twentieth Century Fox Film Corp. v. iCraveTV* (Civil Action No. 00-121 (W.D. Pa. 28 Jan. 2000)), which was a copyright infringement suit where jurisdiction was asserted over a Canadian defendant which had tried to limit its targeting to Canadian residents, have been contrasted with Judge Fogel's decision in *Yahoo! Inc. v. La Ligue Contre Le Racisme Et l'Antisemitisme* (Case No. C-00-21275 JF, U.S. Dist. Ct. (N.D. Cal. 7 Nov. 2001)).

53. *See* discussion in Coffee, *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 Bus. Law. 1195, 1227-32, suggesting international treaties as a potential approach. In November 2001, the SEC sponsored a Major Issues Conference on Securities Regulation in the Global Internet Economy, which was the first SEC-supported conference since 1984 that was devoted to examining broad policy issues in securities regulation. *See* http://www.sec.gov/news/headlines/majorissues.htm.

54. Stéphan Le Goueff, *Offering Financial Services on the Web: Experiencing the World Wide (Legal) Web*, World Internet L. Rep. (BNA) (Feb. 2001), at 26. The SEC has issued guidance rules for the offer of securities on the Internet in the U.S. which are contained in the SEC International Series Release No. 1125, effective as of 23 March 1998.

55. *Id. See also, FSA Introduces Guidelines on Foreign Firms' Internet Ads*, WORLD INTERNET L. Rep. (BNA) (Feb. 2001), at 6.

56. Bowman, *Global treaty could transform Web*, CNET News.com (22 June 2001), located at http://news.cnet.com/news/0-1005-200-6345725.html.

57. Benner, *New World Order, Copyright Style*, Wired News (11 Sept. 2001), located at http://www.wired.com/news/politics/0,1283,46676,00.html.

58. Bertrand, *Collective Administration of Copyrights, Artists Rights and the Law of Publicity on the Internet: Current Issues and Future Perspectives*, 3 New York State Bar Association International Law and Practice Section Fall Meeting 1227 (1996); Gigante, *Ice Patch on the Information Superhighway: Foreign Liability for Domestically Created Content*, 14 Cardozo Arts & Ent. L.J. 523 (1996). A proposed Convention on Transfrontier Computer-Network Communications contained in the Gigante article is available at http://dvorak .org/gigante/. The treaty would prohibit signatories from regulating or restricting communications and e-mail originating outside their territory and passing or routed through any part of a computer network located on their territory, and would apply the civil law of the originating party to determine private rights and obligations with respect to a communication.

59. *See also U.S. v. Mohrbacher*, 182 F.3d 1041 (9th Cir. 1999) (person who downloads contraband from computer bulletin board is guilty of receiving contraband, but not of shipping or transporting it; provider of bulletin board would be guilty of the latter).

60. *Amberson Holdings LLC v. Westside Story Newspaper* (D. N.J. 2000), *reported in* 60 Pat. Trademark & Copyright J. 686 (10/27/00).

61. The E-Commerce Directive was scheduled to be implemented by the legislatures of all E.U. Member States by 17 January 2002. However, as this deadline approached many E.U. Member States came to the realization that their citizens might become subject to the commercial laws of other E.U. states rather than their own and the legislatures of such states were concerned their citizens would not be adequately protected. Thus, as of December 2001 only Luxembourg was on track to have implementing legislation by the designated date. *E-Commerce Directive is "Working Well,"* World Internet L. Rep. (BNA) Dec. 2001, at 6.

62. Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 (the "E-Commerce Directive"), available at com31en.pdf, Recital (22), Annex.

63. *Id.*, Recitals (29), (53), (55), (56), (65), Art. 1, § 3, Annex.

64. *Id*., Recital (55).

65. Council Regulation No. 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgements in Civil and Commercial Matters, art. 15(c).

66. *See* http: //www.europa.eu.int/comm/justice_home/civil/consultation/index__en.htm.

67. *Proposed European e-commerce law would stifle business*, 25 July 2001, located at http://www.iccwbo.org/home/news_archives/2001/e_commerce_law.asp.

68. Marino and Fontana, *The EU Draft Directive on Electronic Commerce*, World Internet L. Rep. (BNA) (3/00), at 26.

69. Szuskin and Saarinen, *Enactment of the Decree Relating to E-Signatures*, World Internet L. Rep. (BNA) (June 2001), at 7.

70. Stephanie Tsacoumis and Victoria P. Rostow, *E-SIGN Your Life Away: Digital Signatures in the New Economy*, 4 WallStreetLawyer.com, at 20.

71. UETA was approved by the National Conference of Commissioners on Uniform State Laws at its annual meeting in July 1999.

72. For current statistics on the adoption of the UETA, *see* http://www.nccusl.org/nccusl/pubndrafts.asp.

73. *Most UETA Bills Introduced in 2001 Pass*, World Internet L. Rep. (BNA) (Sept. 2001), at 17.

74. Stewart Baker, quoted in *U.N. Commission to Consider Draft Model Law on E-Signatures at June Meeting*, World Internet L. Rep. (BNA) (May 2001), at 31.

75. *See*, *e.g*., *Ford Motor Co. v. Texas Dep't of Transp.*, No. 00-50750 (5th Cir. 2001) (Internet sale by Ford of used motor vehicles violated state statute prohibiting automobile manufacturers from retailing motor vehicles to consumers); *National Football League v. Miller*, No. 99 Civ. 11846(JSM), 2000 WL 335566 (S.D.N.Y. 2000) (income derived by defendant from New Yorkers placing bets through advertisers on defendant's *Web site* created jurisdiction in New York); *Euromarket Designs Inc. v. Crate & Barrel Ltd.* (E.D. Ill. 2000) (completed Internet transaction between Irish vendor and Illinois resident constituted sufficient contacts for jurisdiction); *American Eyewear Inc. v. Peeper's Sunglasses and Accessories Inc*. (N.D. Tex. 2000) (personal jurisdiction created in Texas by regular Internet transactions of Minnesota corporation with Texas residents); *People Solutions, Inc. v. People Solutions, Inc,* No. 3:99-CV-2339-L, 2000 U.S. Dist. LEXIS 10444 (N.D. Tex. 2000) (Web site allowing Texas residents to order goods online insufficient to establish personal jurisdiction because no goods actually sold to Texas residents), *but cf. America Online Inc. v. Huang*, No. 00-290-A (E.D. Va. 2000) reported in 60 Pat. Trademark & Copyright J. (BNA) 258 (28 July 2000) (registration of Internet domain name with Virginia–based company was insufficient contact to create jurisdiction); *contra*, *Bancroft & Masters Inc. v. Augusta Nat'l Inc*., No. 99-15099 (9th Cir. 18 Aug. 2000), reported in 60 Pat. Trademark Copyright J. (BNA) 366 (25 Aug. 2000) (protest letter sent to domain name registrar in state sufficient to provide jurisdiction).

76. Alaska Administrator of Securities, In Re: Offers Effected Through Internet That Do Not Result in Sales of Securities in Alaska, Admin. Order 96-065 (20 Dec. 1995); Indiana Sec. Div., In the Matter of: Securities Offered on the Internet but Not Sold in Indiana, Order No. 95-0115 AO (15 Nov. 1995); Texas Sec. Bd., § 139.17, Offer Disseminated Through the Internet; all *cited in* E. Schneiderman & R. Kornreich, *Personal Jurisdiction and Internet Commerce*, N.Y.L.J. 4 June 1997, at 1.

77. *See* Coffee, *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 Bus Law. 1195, 1219-21 (1997), *citing* IPOnet, SEC No-Action Letter, 1997 SEC No. Act. LEXIS 642 (July 26, 1996); Angel Capital Electronic Network, SEC No-Action Letter, 1997 SEC No. Act. LEXIS 812 (Oct. 25, 1996); Lamp Technologies, Inc. SEC No-Action Letter, 1997 SEC No-Act. LEXIS 638 (May 29, 1997).

78. Order No. 97-0378AO, Bus. Fran. Guide (CCH) ¶ 5140.011 (Dec. 24, 1997).

79. Code of Md. Regs., Div. of Securities § 02.02.08.18.

80. Dep't of Law, Bureau of Investor Protection and Securities–Codes, Rules and Regulations of the State of N.Y., Tit. 13, Ch. VII § 200.13 (1999), Bus. Fran. Guide (CCH) ¶ 5320.13.

81. Nine of the franchise registration states require franchisors that offer franchises in those states to file copies of their franchise sales advertisements prior to publication. Goldman & Forseth, *Internet Franchise Advertising: Will Franchise Regulation Join the Information Age?*, 7 LJN's Franchising Bus. News & L. Alert 11 (Aug. 2001), at 6.

82. Likewise, the Federal Trade Commission has issued a notice of proposed rulemaking with respect to the dissemination of financial performance representations outside of the offering circular, including Internet advertising. *Id.* at 5.

83. Statutory Instrument 2000 No. 2334, available at www. legislation.hmso.gov.uk/si/si2000/20002334.htm; "New Rules Governing Sales to Consumers over the Internet" *located at* www.elexica.com/items/data/d9c607dc9.htm

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Harmonization of Rules of Origin and Developments in Antidumping

By Jon R. Johnson

I. Introduction

The Doha Round of negotiations was initiated on 14 November 2001, and is the first round of trade negotiations to be held under the *Agreement Establishing the World Trade Organization* ("WTO Agreement") that became effective on 1 January 1995.

Trade facilitation is a high priority in this round of negotiations.[1] Rules of origin can create significant barriers to trade through excessive complexity, inconsistency and outright protectionist effect. The drafters of the WTO Agreement addressed these issues in the Agreement on Rules of Origin ("Rules of Origin Agreement") in Annex 1A of the WTO Agreement by initiating a harmonization program for non-preferential rules of origin and establishing disciplines that apply to non-preferential rules of origin during the transition period. It was originally intended that the harmonization process would be completed by 1998 or 1999. However, the harmonization negotiations are still ongoing and will continue as the Doha Round negotiations proceed. The purpose of this paper is to briefly describe the progress made in the harmonization program to date and to make a few observations respecting its ultimate application.

Dumping has been addressed in all of the GATT negotiating rounds since the Kennedy Round in the early 1960s, which resulted in an antidumping code. The Tokyo Round also resulted in an antidumping code and the Tokyo Round code was carried forward, with some modification, into Annex 1A of the WTO Agreement as the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("AD Agreement"). Unlike the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), which established an internationally agreed definition of a "subsidy" for the first time in GATT negotiating history, the AD Agreement was not considered particularly groundbreaking. However, the AD Agreement has been one of the most extensively litigated of all the WTO agreements. The interpretation of provisions of the AD Agreement by successive panels and the Appellate Body has significantly altered the international law respecting antidumping. The decisions in those cases will significantly affect the Doha antidumping negotiations,[2] with some Members seeking to codify the findings of panels and the Appellate Body and others perhaps seeking to negate them.

II. Harmonization of Non-Preferential Rules of Origin Under the Rules of Origin Agreement

A. The Harmonization Work Program

The Rules of Origin Agreement initiated a process whereby WTO Member countries would ultimately harmonize their non-preferential rules of origin. Non-preferential rules of origin are origin rules that are used for purposes other than determining the eligibility of a good for a preferential under a free trade agreement such as the North American Free Trade Agreement (NAFTA) or under an autonomous trade regime such as the Generalized System of Preferences that accords preferential tariff treatment to goods of many developing countries.[3] The non-preferential rules of origin covered by the Rules of Origin Agreement are broadly defined in Article 1(2) to include all "rules of origin used in non-preferential commercial policy instruments." Article 1(2) lists specific examples of such rules as rules respecting the application of most-favored-nation treatment, antidumping and countervailing measures, safeguard measures, origin marking requirements, quantitative restrictions or tariff quotas, government procurement and trade statistics.

The ultimate objective of the Rules of Origin Agreement is to develop a harmonized set of rules, agreed to by all Members, to be used for all these various purposes. Part IV of the Rules of Origin Agreement establishes a work program to be undertaken by the Members in conjunction with the Customs Co-operative Council (CCC). A Committee on Rules of Origin ("Committee") was established for the purpose of conducting this work, and the Committee was to be assisted by a Technical Committee established under the auspices of the CCC.[4] Pending completion of the work program (the "transition period"), Members are subject to a number of disciplines in respect of non-preferential rules of origin. The most significant of these disciplines is that such rules are not be used to pursue trade objectives or to create restrictive, distorting or disruptive effects on international trade.[5] Upon the completion of the transition period, Article 9(4) of the Rules of Origin Agreement provides that the Ministerial Conference will establish the results of harmonization program in an annex as an integral part of the Rules of Origin Agreement and will establish a timetable for its implementation.

The drafters of the Rules of Origin Agreement believed, somewhat naively, that the work could be completed within a three-year period.[6] The Rules of Origin Agreement came into effect on 1 January 1995 and the work program is still ongoing, with many outstanding items yet to be resolved. It was clearly thought at the time that the Rules of Origin Agreement that the harmonization process would have been completed by the time another negotiating round commenced. But the Doha Round was initiated on 14 November 2001 and the harmonization program is nowhere near complete. The negotiation of the harmonized non-preferential rules of origin will continue as the Doha Round of negotiations proceed.

Once the harmonization negotiating process is complete, there will be issues as to what matters the new harmonized rules must be applied. The scope of Article 1(2) of all "rules of origin used in non-preferential commercial policy instruments" is very broad: it would encompass origin rules used for domestic purposes, such as the enforcement of fair business practices codes respecting representations about the origin of goods. When it comes to actually applying the harmonized rules, Members may wish to negotiate a more restrictive scope. Also, Members will have to reconcile their own non-preferential rules of origin (such as marking rules) with the requirements of the harmonized rules.[7] This will doubtless create some difficulties. For example, if textile restraint agreements are still in effect (which would be the case if the harmonized rules become effective before 1 January 2005, the date set for full integration into the General Agreement on Tariffs and Trade 1994 (GATT 1994) under the Agreement on Textiles and Clothing), goods formally subject to restraint may no longer subject to restraint, or *vice versa*. There may be some very pointed discussions as to the application of the new harmonized rules over issues such as these.

B. The Committee's Work to Date

While nowhere near completion, the Committee has done a massive amount of work. The extent of this work is apparent from the hundreds of documents that are posted on the WTO Web site.[8] Early on in the negotiating process (10 May 1996), the Committee established an Integrated Negotiation Text for the Harmonization Work Program (INT). There is a section of this document that is entitled "Overall Architecture," which describes how the rules are to function.[9] The INT Appendix sets out product-specific rules in the order of the Harmonized System. The results of negotiations for specific categories of goods are published on the WTO Web site from time to time, as are consolidations of the INT. For example, Document G/RO/45/Add.15/Rev.1, dated 12 November 2001, covers HS Chapters 84-90 (Machinery).[10] Document G/RO/45/Add.1/Rev.2 covers HS Chapters 50-63 (Textile Products) and Textile Related Chapters.[11]

The architecture of the rules set out in the INT is not dissimilar to other rules of origin. Goods are goods of a country if they are wholly obtained in that country or substantially transformed in that country. Appendix 1 of the Overall Architecture sets out rules for determining when goods are wholly obtained. The number of alternative texts in this Appendix indicates that this issue is not settled. Appendix 2 of the Overall Architecture makes reference to "Product Specific Rules of Origin" that will apply to goods that are not wholly originating. These are the rules that define substantial transformation and the Appendix will define a "primary rule" for each good grouped in accordance with Harmonized System (HS) headings and subheadings. The primary rules are largely based on changes in tariff classification (tariff shifts), which are frequently accompanied by processing requirements. Some primary rules are based solely on processing requirements, and some contain value-added requirements.

If a primary rule is satisfied in a country, that country is the country of origin. If no primary rule in respect of a good is satisfied within a single country, there are a number of residual rules for determining the country of origin. For example, if the good is produced from materials that all originated in a single country, and the processing in a second country did not satisfy the primary rule that applied to the good, the country or origin of the good is the country from which the materials originated.[12] There are a number of other residual rules dealing with situations where the materials came from multiple sources. Residual rules will also be set out as HS Chapter notes throughout the Appendix.

C. Concluding Remarks

If the harmonized rules come into effect, they will certainly achieve the objectives of ensuring certainty and predictability and precluding rule manipulation for protectionist purposes. However, they will not be easy to administer because of their complexity. This may be a particular problem for developing countries that have difficulty in implementing the most basic of WTO obligations. Also, the harmonized rules may not apply to the very broad range of non-preferential origin rules identified in Article 1(2) of the Rules of Origin Agreement, since Members may resist giving up their own origin-of-goods regimes in certain areas that they regard as sensitive.

III. The WTO Antidumping Regime

A. Basic Principles

Article VI of GATT 1994 permits Members to impose antidumping duties to offset or prevent dump-

ing. However, an antidumping duty cannot exceed the margin of dumping, which is the excess of the normal value over the export price. The normal value is the domestic price of the exported good in the exporting country or, failing that, the highest comparable price for export to a third country, or the cost of production plus selling costs plus an amount for profit. The export price is the price at which the exported good is sold in the importing country. Article VI:6(a) of GATT 1994 provides that no WTO Member shall levy an antidumping duty against the importation of a product from another WTO Member unless it determines that the effect of the dumping is to cause material injury or threat of injury to an established domestic industry or to retard materially the establishment of a domestic industry.

The basic rules in Article VI of GATT 1994 are amplified by the AD Agreement. AD Article 1 provides that an "anti-dumping measure shall be applied only under the circumstances provided for in Article VI of GATT 1994 and pursuant to investigations initiated and conducted in accordance with the provisions of this [i.e., the AD] Agreement." AD Article 18.1 reinforces the principles set out in AD Article 1 by providing that "[n]o specific action against dumping of exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement." These two provisions clearly establish that the only action that a Member can take against dumping is to impose an antidumping duty. Any other action taken against dumping is inconsistent with WTO obligations.

These principles were applied in *United States—Anti-Dumping Act of 1916 ("1916 Case")*.[13] In this case, the European Union (the "EC") and Japan challenged a U.S. measure against dumping that, rather than imposing an antidumping duty, imposed a criminal penalty for dumping and provided for a civil right of action (with treble damages) in favor of those adversely affected by dumping. Both the panel and the Appellate Body found that these measures were "antidumping measures" (in that they were taken against the practice of dumping) that clearly did not conform to Article VI of GATT 1994 and the AD Agreement. These criminal and civil measures against dumping were not antidumping duties—the only measure against dumping that is permitted—and clearly were not pursuant to investigations conducted in accordance with the AD Agreement.

B. Panel and Appellate Body Findings Respecting Substantive Provisions of the AD Agreement

The substantive provisions of the AD Agreement respecting antidumping actions have been amplified and clarified by panel and Appellate Body findings.

1. Normal Value

AD Article 2 sets out detailed requirements respecting the determination of normal value, export price and margin of dumping. For example, AD Article 2.4 requires that a fair comparison be made between the export price and the normal value in determining dumping margins, and sets out rules for accomplishing this.

In *European Communities—Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India* ("*EC Bed Linen*"),[14] India challenged the EC's practice of "zeroing" in calculating dumping margins. The products covered by the investigation (cotton-type bed linen) included a number of different "models" (e.g., pillowcases, duvet covers, etc.). The EC calculated dumping margins for each "model," and then added up the individual dumping margins to arrive at an overall dumping margin for the product as a whole. However, negative margins (where the export price exceeded the normal value) were treated as being equal to "zero," and hence the expression "zeroing." The Appellate Body found that zeroing was inconsistent with AD Article 2.4.2, which requires that margins of dumping be established "on the basis of a weighted average normal value with a weighted average of prices of all comparable export transactions." The Appellate Body found that zeroing the negative margins effectively treated the export prices for the affected transactions as less than they really were, and, therefore, failed to take into account the prices of *all* comparable transactions.

Zeroing is a common practice of investigating authorities in antidumping cases. The U.S. practice of zeroing has arisen as an issue in the recent antidumping actions by the U.S. against Canadian softwood lumber imports. The U.S. Department of Commerce ("Commerce") took the position that it was not bound by the *EC Bed Linen* decision and that it was entitled to zero.[15] Zeroing will be an issue that negotiators will have to address in the Doha Round, with some Members seeking to codify the *EC Bed Linen* ruling, so that all Members are bound by it and other Members resisting that approach.[16]

There have been several other cases involving AD Article 2.4. In *Argentina—Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy* ("*Argentina—Ceramics*"),[17] Italy complained that the Argentine authority in an antidumping investigation acted inconsistently with Article 2.4 by considering the size of ceramic tiles and nothing else when considering adjustments for physical differences affecting price comparability. In *United States—Anti-Dumping Measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strip from Korea* ("*Korea—Plate and Sheet*"),[18] a panel found

that Commerce had made an unnecessary currency conversion contrary to AD Article 2.4.1.

2. Injury

AD Article 3 elaborates on the requirement in Article VI:6(a) of GATT 1994 that an antidumping duty cannot be imposed unless the dumping is causing or threatening material injury to an existing domestic industry or retardation of a new domestic industry. AD Article 3.1 requires that a determination of injury be based on positive evidence and involve an objective examination of the volume of dumped imports and the effect on domestic prices for like products, and the consequent impact on domestic producers of such products. AD Article 3.4 lists fifteen factors that must be taken into account when examining the impact of dumped imports on the domestic industry.[19] This list is not exhaustive and no one factor is decisive. In *Thailand—Anti-Dumping on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland* ("*Thailand Angles*"),[20] Poland successfully challenged an antidumping duty imposed by Thailand on the basis that the antidumping authorities had not taken all these factors into account.

AD Article 3.5 requires the demonstration of a causal relationship between the dumped imports and the injury, based on an examination of all the relevant evidence between the authorities. The authorities must also examine any known factors, other than the dumped imports, that at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the dumped imports.

In *United States—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan* ("*US—Japan Hot-Rolled*"),[21] the Appellate Body found that, where there were other factors causing injury besides the dumped imports, the investigating authority had to "appropriately assess the injurious effects of those other factors" in order to ensure that "the injurious effects of the other known factors are not 'attributed' to dumped imports." In order to do this, the investigating authority had to separate and distinguish the injurious effects of the dumped imports from the injurious effects of those other factors. This requires a satisfactory explanation of the nature and extent of the injurious effects of the other factors, as distinguished from the injurious effects of the dumped imports.

AD Article 3.7 sets out several factors to be considered in making a determination regarding the threat of injury. In *Mexico—Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) From the United States* ("*Mexico—Corn Syrup*"),[22] a panel found that the investigating authority had failed to carry out its investigation as required under Article 3.7, as well as under Articles 3.1 and 3.4.

3. Initiation of the Investigation

Article 5 sets out detailed requirements that must be observed by administrative authorities when initiating and conducting dumping investigations. A dumping investigation must be commenced upon the written application of the domestic industry. The application must include evidence of dumping, injury and a causal link between the two. The application must be supported by producers accounting for at least twenty-five percent of the value of production of the domestic industry (and at least fifty percent of the producers expressing support or opposition).

Dumping and injury evidence must be considered simultaneously, and investigations must be terminated immediately if margins are *de minimis* (i.e., less than two percent) or if the volume of dumped imports or the injury is negligible. In *Guatemala—Definitive Anti-Dumping Measures on Grey Portland Cement from Mexico* ("*Guatemala—Portland Cement*"),[23] a panel found that there was insufficient evidence of either dumping or injury in the application to justify the initiation of the investigation, and that the initiation of the investigation contravened AD Articles 5.2 and 5.3. However, in *Mexico—Corn Syrup*, where a panel considered complaints that Mexico had violated Article 5 in initiating its investigation, the panel upheld the decision of the Mexican authorities and decided that the investigating authorities did not have to consider all the factors in AD Article 3.4 (referred to above) in deciding to investigate.

4. Conduct of the Investigation

AD Article 6 sets out procedural rules in regard to the conduct of dumping investigations, including rules relating to evidence, confidential information, minimum time limits for completing questionnaires and the use of facts available when interested parties do not supply information.

In *Guatemala—Portland Cement*, the panel found that the authorities in Guatemala had breached AD Article 6.1.2 by failing to make evidence presented by one interested party available to other interested parties.

In *Argentina—Ceramics*, the panel had to determine whether the investigating authority acted consistently with AD Article 6.8 by resorting to facts available on the grounds that the exporters allegedly failed to provide sufficient supporting documentation. The investigating authority did not clearly inform the exporters that they were required to submit such documentation and that an absence of supporting documents would mean their information would be rejected. The panel found that the investigating authority acted inconsistently with AD Article 6.8 when it disregarded the exporters' information concerning export price and normal value information. The panel also found violations of AD Articles 6.9 and 6.10.

5. Provisional Measures

AD Article 7 permits the application of provisional measures in the form of provisional duties or security by way of a cash deposit or a bond equal to the amount of antidumping duties provisionally estimated. Provisional duties may not be imposed earlier than sixty days after initiation of the investigation and may not be applied for longer than four months (or six or nine months in some instances described in AD Article 7.4). In *Mexico—Corn Syrup*, the panel found that AD Article 7.4 clearly limits the period of application of a provisional measure to a period of no longer than six months and provides no basis for extension of that period. The panel found that Mexico had violated this provision.

6. Retroactive Duties

AD Article 10 permits retroactive application of duties in some instances. If there is a final determination of injury, and in certain instances when there is a final determination of threat of injury, the antidumping duties apply retroactively for the period during which provisional duties have been applied. AD Article 10.6 also permits retroactive duties in "critical circumstances," which occur when there has been a history of dumping and the injury is caused by massive dumped imports. The duties can be imposed retroactively for a period that runs not more than ninety days before the date of application of provisional measures. In *Mexico—Corn Syrup*, the panel found that it was clear from the language of AD Article 10.2 that retroactive imposition of antidumping duties is permissible only in those instances in which the particular conditions set forth in AD Article 10.2 exist. Furthermore, the failure expeditiously to release bonds and/or cash deposits collected under the provisional measure was found to be inconsistent with AD Article 10.4.

7. Administrative Reviews

AD Article 11.1 provides that an antidumping duty is to remain in force only as long as and to the extent necessary to counteract dumping that is causing injury. AD Article 11.2 requires that the authorities review the need for the continued imposition of antidumping duties on a periodic basis, either on their own initiative or upon the request of any interested party who submits positive information substantiating the need for a review. AD Article 11.3 requires that antidumping duties be terminated on a date not later than five years following their imposition (or the date of the most recent review under AD Article 11.2 if both dumping and injury have been considered) unless authorities determine that the expiration of the duty would likely lead to the continuation or resumption of the dumping and injury.

In *United States—Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea* ("*U.S.—DRAMS*"),[24] Korea challenged certain U.S. regulations in regard to the revocation of antidumping orders. The regulation in question provided for revocation of an order on the basis that it "is *not likely* that those persons will in the future sell the merchandise at less than foreign market value" (i.e., dumping) (emphasis added). Korea argued that the "not likely" criterion was inconsistent with AD Article 11.2. The panel noted that both parties had argued that AD Article 11.1 was a general rule that was implemented through AD Articles 11.2 and 11.3. The panel agreed with the parties that, by virtue of AD Article 11.1, an antidumping duty may only continue to be imposed if it remains "necessary" to offset injurious dumping. The panel was of the view that AD Article 11.1 contained a general necessity requirement, whereby antidumping duties "shall remain in force only as long as and to the extent necessary" to counteract injurious dumping. The panel also agreed that the application of the general rule in AD Article 11.1 is specified in AD Article 11.2, which provides that "authorities shall review the need for the continued imposition of the duty," and requires that authorities "examine whether the continued imposition of the duty is *necessary* to offset dumping" in the context of AD Article 11.2 dumping reviews. The panel found that the "not likely" standard established by the regulation in question was "manifestly irreconcilable with the requirements of meeting a standard of necessity which involves demonstrability on the basis of the evidence adduced."

C. Dispute Resolution under the Antidumping Agreement

The AD Agreement is unique among the WTO agreements in setting out time limits within which dispute settlement proceedings can be invoked. The AD Agreement also sets out standard of review provisions to be observed by WTO panels. These provisions have been substantially clarified by WTO case law.

1. Time for Invoking Procedures

AD Articles 17.1 to 17.3 make provision for dispute resolution under the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and use language similar to that in other WTO agreements, by providing that dispute resolution commence with a request for consultations. However, AD Article 17.4 provides that, if consultations have been requested and final action has been taken by an importing Member to levy definitive antidumping duties or to accept a price undertaking, or if a provisional measure has a significant impact, the Member may refer the matter to the Dispute Settlement Body (DSB). This has the effect of requiring that a Member must wait at least until provisional measures have been imposed before requesting a panel.

In the *1916 Case*, the U.S. took the position that the panel did not have jurisdiction to hear the matter because none of the events in AD Article 17.4 had occurred. However, none of the events could possibly have occurred because the antidumping measure complained of imposed civil and criminal proceedings and did not make provision for provisional measures, antidumping duties or undertakings. The Appellate Body distinguished between a challenge of an action taken by a national investigating authority in the context of an antidumping investigation and a claim of inconsistency of antidumping legislation with the AD Agreement, and found that the panel did have jurisdiction despite AD Article 17.1.

2. Standard of Review

AD Article 17.6 is also unique in that it establishes a standard of review for panels reviewing the findings of authorities applying antidumping laws that is more stringent than the general standard under DSU Article 11.[25] Article 17.6(i) requires that a panel assess whether the authorities' establishment of the facts was proper and whether their evaluation was unbiased and objective. If these requirements are satisfied, the panel may not overturn the evaluation, even though the panel might have come to a different conclusion. Article 17.6(ii) provides that customary rules of interpretation are to be applied, but if a provision of the AD Agreement permits more than one permissible interpretation, the panel must find the authorities' measure to be in conformity if it rests on one of those interpretations.

In *Thailand—Angles* the Appellate Body described the provisions of Article 17.6(i) as preventing panels from second-guessing the determinations of national authorities when the establishment of the facts is proper and the evaluation unbiased and objective. The Appellate Body concluded that the panel had fulfilled the requirements of Article 17(ii) in respect of its interpretation of AD Article 3.4 by applying the customary rules of interpretation of public international law, as required by Article 17(ii), and upheld the panel's interpretation.

IV. Implementation of Panel Decisions

Although panel and Appellate Body findings have substantially clarified substantive provisions of the AD Agreement, panels have avoided addressing the issue of implementation. In several complaints, the complainant has requested an order that improperly imposed duties be refunded. Panels have responded to such requests by finding that a panel did not have the authority to make such an order.[26]

Canada attempted to engage the issue of implementation in its complaint in *United States—Section 129(c)(1) of the Uruguay Round Agreements Act* ("*Section 129(c)(1) Case*").[27] Section 129 of the Uruguay Round Agreements Act sets out the U.S. procedures for implementing panel and Appellate Body findings in antidumping and countervailing duty cases. Section 129(c)(1) provides that a determination implementing a finding applies only to goods entered after the determination became effective.[28] Suppose that a panel found that an injury determination by the International Trade Commission (ITC) was incorrectly decided and that, as a result, the ITC issued a new negative injury determination. Under Section 129(c)(1), the new negative determination would apply only to goods entered after the date that the new determination took effect. Unliquidated entries of goods before that date would still be subject to antidumping duties, since in administrative reviews in regard to those goods, the affirmative injury determination would still apply. In its argumentation, Canada agreed with the U.S. position that WTO findings apply prospectively, but claimed that it was not seeking retroactive application.

The panel avoided deciding the main points raised by Canada by adopting an extremely narrow view of Canada's Request for a Panel. In its Request, Canada referred only to Section 129(c)(1) and the U.S. Statement of Administrative Action (SAA) and not to other provisions of U.S. antidumping law. The panel concluded that the only measure within its terms of reference was Section 129(c)(1),[29] and did not consider other provisions of U.S. antidumping or countervailing duty law. The panel decided that U.S. authorities had the discretion to act consistently with WTO requirements under Section 129(c)(1) and the SAA, and accepted the U.S. mandatory/discretionary defenses.[30] However, the panel shed no light on what Members' obligations were in regard to implementation of adverse panel or Appellate Body reports in antidumping or countervailing duty cases because the panel reversed the order of proceeding followed in other recent cases involving the mandatory/discretionary defense.[31] The panel first decided that U.S. authorities under Section 129(c)(i) and the SAA had acted consistently with WTO obligations. Having decided that, the panel made no finding as to whether Section 129(c)(1), by restricting the application of an implementing order or determination to goods entered after a certain date, was inconsistent with WTO requirements.

Significant issues remain outstanding respecting the implementation of panel and Appellate Body reports that find that investigating authorities of a Member acted improperly in imposing antidumping duties. From one perspective, a Member should be obliged to refund all antidumping duties imposed contrary to WTO requirements. However, this raises the issue that, if such a refund should be required with respect to antidumping duties, why should it not also be required with respect to any tax that is imposed contrary to WTO requirements? The difficulty with this position is that in some instances a Member may have been impos-

ing a tax inconsistently with WTO requirements for many years and a refund is impracticable because of the sheer magnitude of the amount that would have to be refunded. On this basis, WTO findings should only apply prospectively. Why should this argument for prospective application not apply to antidumping duties as well? The response to this question might be that antidumping duties, like countervailing duties but unlike other taxes, are clearly recognized as extraordinary and are permitted under the WTO regime for the sole purpose of offsetting an unfair trade practice. Therefore negative panel or Appellate Body findings regarding the application of these extraordinary duties should be subject to a different and stricter regime of implementation.

There is also the issue that, if the rule for antidumping duties is to have prospective implementation in adverse panel and Appellate Body reports, how should that rule be applied? The United States has a retroactive system, where deposits are collected when goods enter and the duty is subsequently determined in an administrative review. If the implementing order or determination becomes effective after the goods enter but before the duties are actually assessed, should authorities be required to apply the new order or determination in the administrative review or be permitted to apply the old order or determination, even though it has been found to be WTO-inconsistent? If the former, does this not discriminate against a retrospective system as compared with a "prospective" collection system, where antidumping duties are collected at the time that the goods enter?[32]

These are some of the questions in regard to the WTO antidumping regime that will have to be addressed by the Doha Round negotiators.

V. Concluding Remarks

Article 28 of the Doha Declaration is very general in its description of the negotiations that will take place in respect to the AD Agreement. So far as substantive obligations are concerned, the disciplines imposed have turned out to be quite fulsome. AD Article 2.4 has been found to be an effective discipline in regard to the practice of zeroing. Decisions such as *Japan—Hot Rolled*, if consistently followed, will force administering authorities to be much more analytical in their analysis of injury determinations. The disciplines provided in the substantive provisions of the AD Agreement may be best clarified and improved by codifying some of the findings made in the case law.

As noted above, the AD Agreement sets out several rules respecting the degree of deference to be given to administering authorities that do not appear in other WTO agreements. Having regard to the sheer volume of WTO cases that have revolved around the AD Agreement, there may be pressure from some Members (notably the United States, which has lost a number of these cases) to clarify the extent to which panels and the Appellate Body can second-guess the actions of administering authorities.

As noted above, the thorniest aspect of the AD Agreement appears to be implementation of adverse panel and Appellate Body reports. The author is of the view that improperly imposed antidumping duties should be refunded in their entirety, regardless of whether the impropriety results from a breach by the authorities of domestic law or of WTO law. However, while some Members may press for a clarification along these lines, the majority of Members will likely prefer to reserve the option of applying adverse reports on a prospective basis, at a time of their own choosing.

Endnotes

1. The Doha Declaration, paragraph 27.
2. The Doha Declaration, paragraph 28. This paragraph states that the negotiations are aimed at clarifying and improving disciplines under the AD Agreement and the SCM Agreement while preserving their basic concepts, principles and effectiveness.
3. Annex II of the Rules of Origin Agreement sets out a Common Declaration with Regard to Preferential Rules of Origin. The Common Declaration sets out some general criteria that preferential rules of origin should follow. Preferential rules of origin, at least those set out in free trade agreements, are negotiated between the parties to these agreements and reflect the arrangement arrived at by the parties. The drafters of the WTO Agreement clearly saw no need to harmonize these individually negotiated arrangements by which certain countries accord preferences to the goods of certain other countries.
4. Rules of Origin Agreement, Article 4.
5. Rules of Origin Agreement, Articles 2(b) and (c), respectively.
6. Rules of Origin Agreement, Article 9(2)(a) mandates completion within this time frame.
7. The NAFTA Marking Rules of each of Canada, United States and Mexico are inconsistent in some respects with some of the harmonized rules that have been agreed to thus far. Query whether the three NAFTA countries will replace their NAFTA Marking Rules with the new harmonized rules, or continue to apply their respective NAFTA Marking Rules as amongst themselves?
8. *See* http://docsonline.wto.org/GEN_searchResult.asp. A search of "Committee on Rules of Origin" listed almost a thousand documents.
9. For the latest version of the Overall Architecture, see G/RO/45/Rev.2 (25 June 2002).
10. This is a very confusing document because, obviously, many issues remain unresolved. In many instances, the document sets out various alternatives that are being considered rather than rules that have been settled. Note that "HS" refers to the Harmonized System.
11. These rules are complex. As with the NAFTA preferential rules respecting textile and apparel goods, in many instances the tariff shift rules preclude changes from particular headings of subheadings. Many goods are also subject to detailed process requirements.
12. *See* Overall Architecture, APPENDIX 2, Rule 3(e).

13. Panel Report WT/DS136/R 31 March 2000; Panel Report WT/DS162/R 29 May 2000; WT/DS162/Add.1 25 September 2000; Arbitration WT/DS136/11 and WT/DS162/14 28 February 2001.

14. Panel Report WT/DS141/R 30 October 2000; Appellate Body Report, WT/DS141/AB/R 1 March 2001.

15. See the Issues and Decision Memorandum for the Antidumping Investigation of Certain Softwood Lumber Products From Canada where Commerce states respecting *EC—Bed Linen*, "We have no obligation under U.S. law to act on this decision."

16. The U.S. Department of Commerce clearly views zeroing as justified, as do a number of members of the U.S. antidumping bar. Canadian authorities have practiced zeroing in the past, although Canadian views on zeroing seem to be changing with the U.S. dumping determinations in softwood lumber.

17. Report of the Panel, 28 September 2001, WT/DS189/R.

18. Report of the Panel, 22 December 2000, WT/DS179/R.

19. These are actual and potential declines in (1) sales, (2) profits, (3) output, (4) market share, (5) productivity, (6) return on investments, or (7) utilization of capacity, (8) factors affecting domestic prices, (9) the magnitude of the margin of dumping, (10) actual and potential negative effects on cash flow, (11) inventories, (12) employment, (13) wages, (14) growth, and (15) ability to raise capital or investments.

20. Panel Report WT/DS122/R 28 September 2000; Appellate Body Report WT/DS122/AB/R 12 March 2001.

21. Panel Report WT/DS184/R 28 February 2001; Appellate Body Report WT/DS184/AB/R 24 July 2001.

22. Report of the Panel, 28 January 2000, WT/DS132/R,

23. Panel Report WT/DS60/R, 19 June 1998; Appellate Body Report WT/DS60/AB/R 2 November 1998 (Adopted 25 November 1998).

24. WT/DS99/R.

25. Which has been held to be neither total deference nor a *de novo* review.

26. *See, e.g.*, paragraphs 8.5 to 8.14 of the Panel Report in *Japan—Hot Rolled*.

27. WT/DS221/R 15 July 2002.

28. Which occurs when the U.S.T.R. issues certain directions.

29. Panel Report paragraph 6.5.

30. A number of GATT and WTO cases have accepted the defense that a Member's law contravenes GATT or WTO obligations only when it mandates a violation. If the measure allows the authorities the discretion to act in a GATT or WTO-consistent manner, there is no violation.

31. *See, e.g.*, *United States—Measures Treating Exports Restraints as Subsidies*, WT/DS194/R 22 May 2001.

32. Supposedly "prospective" systems have "retrospective" attributes. For example, in Canada, while an assessment of antidumping duties is made when goods enter, there are several levels of redetermination. Suppose a negative panel finding in regard to Canadian antidumping duties were implemented by Canada after the goods entered but before the redetermination. Unlike U.S. law, Canadian law does not address this issue.

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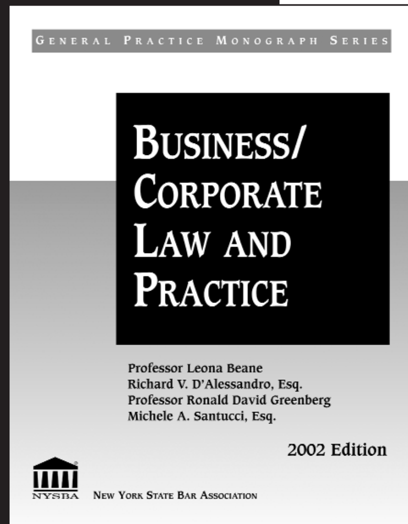

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