

# International Law Practicum

A publication of the International Law and Practice Section  
of the New York State Bar Association

## Practicing the Law of the World from New York

<b>Arbitration and Litigation in Belgium, the Netherlands, the United Kingdom and New York</b> .....	3
<i>Martine De Roeck, Arent van Wassenaeer, Juliet Blanch, and David W. Detjen</i>	

**ARTICLES:**

<b>Obtaining Evidence in Canada for Use in Foreign Proceedings: Principles and Practice</b> .....	20
<i>Peter Balasubramanian and Cynthia Tape</i>	

<b>Corporate Liability Under the Alien Tort Claims Act: United States Court Jurisdiction over International Torts</b> .....	25
<i>Richard T. Marooney</i>	

<b>U.S. Courts as International Courts of Claims: State Law as a Basis for Claims by Non-U.S. Plaintiffs, as Exemplified in <i>In Re World War II Era Japanese Forced Labor Litigation</i></b> .....	33
<i>Margaret K. Pfeiffer</i>	

<b>“Spam Wars”: A European Legal Approach and the Need for an International Cooperation</b> .....	39
<i>Charles-Edouard Renault</i>	

<b>Making Sense of Four Transatlantic Estate Tax Treaties: US-Netherlands, US-Germany, US-France and US-UK</b> .....	47
<i>Michael W. Galligan</i>	

<b>The Impact of EU Law on Cross-Border Taxation Issues Relating to Limitation on Benefits Provisions in Income Tax Treaties Between EC Member Countries and the United States</b> .....	53
<i>James R. Shorter, Jr.</i>	

<b>The Dutch Enterprise Chamber: Key Player in Takeover Disputes</b> .....	61
<i>Scott V. Simpson, Alexander J. Kaarls, and Paul J. van de Grampel</i>	

<b>Structuring Mineral Exploration and Development Joint Ventures in Latin America— An Overview or How to Avoid Putting a Square Peg into a Round Hole</b> .....	72
<i>Hugh Brooke Macdonald</i>	

<b>Section Executive Committee—Officers, Section Committee Chairs and Co-Chairs and International Division Chapter Chairs and Co-Chairs</b> .....	84
---	----



# **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 formatted 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.

Manuscripts are submitted at the sender's risk, and the New York State Bar Association, International Law and Practice Section, assumes no responsibility for the return of material. Material accepted for publication becomes the property of the New York State Bar Association, International Law and Practice Section. No compensation is paid for any manuscript. The *Practicum* reserves the right (for space, budgetary, or other reasons) to move an accepted manuscript from an earlier issue to a later issue. Articles, reports and other materials reflect the views of the authors or committees that prepared them and do not necessarily represent the position of the New York State Bar Association, International Law and Practice Section, or the Editorial Board of the *Practicum*.

## **Deadlines**

Manuscripts intended for publication in the Spring and Autumn issues must be received by the Editor-in-Chief by the preceding 1 December and 1 June, respectively.

## **Reprints**

Each author will receive three complimentary copies of the *Practicum* issue in which the author's material is published. Additional copies may be ordered at cost before an issue goes to press by communicating with Daniel J. McMahon, Esq., at the New York State Bar Association, One Elk Street, Albany, N.Y. 12207-1096 (telephone (518) 487-5582).

## **Back Issues and Advertising**

Requests for back issues, advertising and subscription information and general correspondence should be sent to the Newsletter Dept., New York State Bar Association, One Elk Street, Albany, N.Y. 12207-1096.

Back issues (2000 to present) of the *International Law Practicum* are available online to Section members on the New York State Bar Association's Web site at [www.nysba.org/ilp](http://www.nysba.org/ilp). A searchable index is also available.

# Arbitration and Litigation in Belgium, the Netherlands, the United Kingdom and New York

By Martine De Roeck, Arent van Wassenauer, Juliet Blanch, and David W. Detjen

*Editor's Note: The following is a compilation of four papers prepared for the annual meeting of the International Law and Practice Section of the NYSBA in Amsterdam in October 2003. Each of the authors responded to seven questions regarding both arbitration and litigation in their home country, while also discussing the international aspects of arbitration and litigation. The authors, as well as Michael Schneider of Lalive & Partners of Geneva, Switzerland, also participated in a panel discussion at the annual meeting.*

The seven questions were the following:

1. What institute (for arbitration) or court (for litigation) would be recommendable or available in your jurisdiction?
2. Is discovery allowed (whether before the arbitration or before the trial), and, if yes, how does it work?
3. How long would it take to obtain an award in arbitration or a judgment in litigation?
4. Can the arbitral award be quashed in your jurisdiction, and how long would it take to appeal a judgment?
5. What costs (both internal and external) would be involved in such arbitration or litigation?
6. Would such an arbitral award or a judgment be enforceable in New York?
7. Could such a claim be accompanied by the freezing of assets or an arrest?

## I. Arbitration and Litigation in Belgium

### A. Arbitration

#### 1. What institute would be recommendable in your local jurisdiction?

For most commercial disputes to be settled by arbitration in Belgium CEPINA/CEPANI, the Belgian Centre for Arbitration and Mediation, would be the forum of choice. Its website can be found at <http://www.cepani.be>.

CEPANI was founded in 1969 at the initiative of the Belgian section of the International Chamber of Commerce and the Federation of Belgian Companies. CEPANI has since evolved into an independent arbitration and mediation center comprising business leaders, professors, corporate legal experts, lawyers, notaries and solicitors. It is the largest arbitration and mediation center in Belgium and the only one having international relations. It is the corresponding organ of the International Court of Arbitration of the International Chamber of Commerce (ICC).

CEPANI is active in the study and the promotion of arbitration and mediation, and in the support of arbitration and mediation proceedings. As a result CEPANI has drafted, *inter alia*, arbitration rules for small claims, conciliations and mini-trials.

CEPANI itself does not serve as an arbitrator or mediator. It appoints arbitrators and mediators who undertake to comply with CEPANI's Rules of Good Conduct. It oversees the progress of the proceedings by resolving any legal and material difficulties that might

emerge so as to meet as much as possible the expectations of the parties.

The CEPANI model arbitration clause is as follows:

Any disputes arising out of or in relation with this Agreement shall be finally resolved under the CEPANI Rules of Arbitration by one or more arbitrators appointed in accordance with those Rules.

The following provisions can be added:

The arbitral tribunal shall be composed of one or three arbitrators.

The seat of the arbitration shall be [town or city].

The arbitration proceedings shall be conducted in the \_\_\_\_\_ language.

The proper law of the contract shall be the law of \_\_\_\_\_.

#### 2. Is pre-arbitration discovery allowed; if so, how does it work?

Belgian law does not have a procedure corresponding to that of discovery in the common law system. As a rule, neither of the parties is compelled to produce all the documents pertaining to the case. Each party produces only the documents necessary to sustain its allegations. One can perceive, however, an evolution that has continued for several years, imposing on the parties

certain obligations of collaboration throughout the process.

When there are serious, precise and concurring presumptions that a party to the proceedings is in possession of a document containing the proof of a relevant fact, the arbitrators (not the other party) can order the production of this document, pursuant to Article 1696, § 3 of the Judicial Code juncto Article 877 of the Judicial Code. The production may be made by presenting the original document or a certified copy.

In the case of a problem, the parties should address the Court of First Instance that has jurisdiction over the place of arbitration. Pursuant to Article 1696, paragraph 6 of the Judicial Code, the running of the time periods in the arbitration proceedings is meanwhile suspended.

An *interpretation a contrario* of Article 1696, § 3 of the Judicial Code establishes that an arbitrator may not order the production of a document in the possession of a third party. In such a case the parties must address the Court of First Instance. The arbitrators should give the parties a period of time to avail themselves of this recourse. Articles 877 and 878 of the Judicial Code state that there must be serious, precise and concordant indications that a third party is in possession of a document containing evidence of a relevant fact. If the document proves to be in the possession of such third party, the judge invites this party to deposit the original or a copy to the file on the case in accordance with the terms and conditions determined by the judge pursuant to Article 878 of the Judicial Code. The third party may voice its observations or objections in writing or in a private hearing.

### 3. How long would it take to obtain an award?

A CEPANI arbitral award can be rendered within a relatively short period of time, provided all the parties cooperate to achieve such aim and no extension of time periods is requested or granted. Normally an award should be rendered within four months after the signing of the Terms of Reference, which in turn have to be drafted by the arbitrators and signed by the parties within two months after CEPANI transmitted the file to the arbitrators (which is, in turn, after the appointment of the arbitrators and payment of the fees). However, these time limits can be extended.

According to CEPANI, the average duration of a case is six to twelve months, starting from the moment the arbitrators commence their work until the end of the proceedings.

An appeal constitutes an exception in the field of arbitration. An appeal against an arbitral award is only possible if the parties have provided for this possibility in their arbitration agreement. By submitting their dis-

pute to CEPANI rules, parties waive their right to appeal. Under CEPANI rules, an award is final and not subject to appeal.

### 4. Can this award be quashed in your jurisdiction?

An award can be quashed by way of annulment proceedings before the judicial courts (courts of first instance). Article 1704 of the Judicial Code exhaustively lists the grounds for annulment:

- a. if it is contrary to public order (*ordre public*);
- b. if the dispute was not capable of settlement by arbitration;
- c. if there is no valid arbitration agreement;
- d. if the arbitral tribunal has exceeded its jurisdiction or its powers;
- e. if the arbitral tribunal has omitted to make an award in respect of one or more points of the dispute and if the points omitted cannot be separated from the points in respect of which the award has been made;
- f. if the award was made by an arbitral tribunal that was irregularly constituted;
- g. if the parties have not been given an opportunity to present their case and arguments, or if any other obligatory rule of the arbitral procedure has been disregarded, insofar as such disregard has had an influence on the arbitral award;
- h. if the formalities (prescribed in paragraph 4 of Article 1701) have not been fulfilled;
- i. if the reasons for the award have not been stated;
- j. if the award contains conflicting provisions.

The circumstances mentioned in sub-paragraph (c), (d) or (f) can no longer be invoked if the party availing itself of it was aware of such circumstances during the arbitration proceedings and did not invoke it at that time.

An award may also be set aside:

- a. if it was obtained by fraud;
- b. if it is based on evidence that has been declared false by a judicial decision having the force of *res judicata* or on the basis of evidence recognized as false;
- c. if, after it was made, a document or other piece of evidence is discovered which would have had a decisive influence on the award and was withheld through the act of the opposing party.

In the event that the parties involved are not Belgian, within the meaning of Article 1717 paragraph 4 of the Judicial Code, they may exclude the right to request an annulment by inserting in the arbitration clause the text: “The parties explicitly exclude any application for setting aside the arbitral award.”

Attention should be drawn to the fact that the court, if called upon to adjudicate a request for annulment, may not examine the award as to the merits and substitute its opinion to that of the arbitrators: the court will, for instance, verify whether the motivation condition of the award, a simple formal condition, has been fulfilled, but the court may not examine the intrinsic value of the award and the relevance of the grounds invoked by the arbitrators.

#### **5. What costs would be involved (internal, external)?**

The fee that must be paid to CEPANI covers the administrative costs, as well as the fees of the arbitrators, who are paid by CEPANI. The amount to be paid is calculated in accordance with a tariffs list, based upon the financial value of the dispute. This list can be found on CEPANI’s website. These may be increased with costs such as those of experts and interpreters. The tribunal will generally allocate the costs to the party that loses, to the extent that it loses.

Apart from the fees payable to CEPANI, parties must bear their own attorneys’ fees. Although not required, in practice, in most of the CEPANI arbitrations the parties are represented/assisted by an attorney.

#### **6. Would such award in your opinion be enforceable in New York?**

That depends on the laws of the state of New York. (See Part IV below.) Belgium is a party to the New York Convention of 10 June 1958, as is the United States.

#### **7. Could such a claim be accompanied by the freezing of assets or an arrest?**

Yes, as long as such assets are within Belgian territory. Prior to initiating an arbitration proceeding, the claimant may petition the Judge of Attachments for leave to seize real estate or chattels. A conservatory attachment requires that the plaintiff’s claim is certain, due and liquid, and that the matter is urgent. The petition is granted *ex parte*. The defendant may request lifting such attachment in subsequent opposition proceedings

Exequatur proceedings can also be accompanied by the freezing of assets of the party against whom enforcement is sought. In the event of a final Belgian or foreign arbitral award (fulfilling the conditions of Arti-

cle 1703 of the Judicial Code), no prior leave of the judge of seizures is necessary. In case of any doubt, it is better to request the Judge of Attachments for leave. An arbitral tribunal cannot order seizures.

### **B. Litigation**

#### **1. What courts are available in your jurisdiction?**

Claims pertaining to commercial matters in which (at least) the defendant is a merchant, and exceeding EUR 1,860, are normally brought before a commercial court.

Apart from general jurisdiction, each court also has special competences and exclusive competences. In addition, certain matters must be brought before certain courts, notwithstanding the amount at stake. Thus, for example, bankruptcy cases are within the exclusive competence of the commercial courts.

There are five courts of appeal and one Supreme Court. The Supreme Court deals only with matters of law.

#### **2. Is pre-trial discovery allowed; if so, how does it work?**

As mentioned above, the Belgian law system does not recognize the concept of discovery. Each party produces in principle only the documents necessary to sustain its allegations.

Only when there are serious, precise and concurring presumptions that a party to the proceedings or a third party is in possession of a document containing the proof of a relevant fact can the court (not the other party) order the production of this document, pursuant to Article 877 of the Judicial Code. Production may be made by presenting the original document or a certified copy.

In addition, the production of documents may occur at any time before the oral arguments, which means that if a party wants to reply to the other’s trial brief, it may produce new exhibits to sustain the arguments raised in its additional trial brief.

#### **3. How long would it take to obtain a judgment?**

The duration of a trial depends on several criteria, such as the cooperation of the parties, the nature of the case and the backlog of the courts. A simple case (for instance, the collection of undisputed invoices) can be argued at the introductory hearing, provided that the request to have the case immediately argued was mentioned in the writ of summons. If the defendant does not agree to this, the court will decide whether the case is to be heard immediately or postponed. In practice the defendant almost never agrees and the courts often postpone as soon as some form of defense is submitted.

Ordinary cases argued with normal exchange of trial briefs will take up to two years in the first instance. The most diligent party usually petitions the court to set a binding calendar for the filing of the briefs, pursuant to Article 747 § 2 of the Judicial Code. In its decision, the court also immediately sets a date for the hearing.

In cases where time is of the essence, an award can be rendered within a few days, or at least a few weeks, in summary proceedings before the president of the court.

#### **4. How long would it take to obtain an appeal?**

Decisions on appeal usually take longer than in the first instance, due to the backlog in most courts of appeal.

#### **5. What costs would be involved (internal, external)?**

In general, the party that initiates legal proceedings must advance the court costs (between EUR 82 to EUR 186 per proceeding) and the bailiff fees (approximately EUR 350 per writ notified). The losing party eventually bears these costs.

Apart from the above costs, a party that engages the services of an attorney must bear his or her fees. Apart from a small symbolic amount of approximately EUR 300, the legal fees cannot be recovered from the losing party.

#### **6. Would such judgment be enforceable in New York?**

No treaty exists between Belgium and the United States that governs the enforcement and/or execution of judgments in commercial matters. The enforceable character of the Belgian judgment will depend on the comity rules of the United States.

#### **7. Could such a claim be accompanied by the freezing of assets or an arrest?**

See Part I.A.7 above.

## **II. Arbitration and Litigation in the Netherlands**

### **A. Arbitration**

#### **1. What institute would be recommendable in your local jurisdiction?**

For most commercial disputes to be settled by arbitration in The Netherlands, the Netherlands Arbitration Institute (<http://www.nai-nl.org/english/>) ("NAI"), situated in Rotterdam, would be the forum of choice. It was founded in 1949 by some eminent scholars, including Prof. Pieter Sanders. It has a professional staff and its own offices, which also can provide room for hearings and meetings, if required. Calling upon the resources of many qualified arbitrators in various fields

of expertise, it enjoys a steady reputation in the Dutch arbitration community. Apart from dealing with national disputes, the NAI serves more and more as a service provider for international arbitrations.

In addition, the NAI can also provide summary arbitration proceedings, resulting in an "arbitrary injunction," a provisional award, should time be of the essence. In order for the NAI to have jurisdiction in such arbitral summary proceedings, apart from having agreed through an arbitration clause referring to the NAI Rules, the place of arbitration should be in the Netherlands. By agreeing to this, the parties imply application of the Dutch Code for Civil Proceedings, including provisions for arbitration proceedings under the Arbitration Act of 1986.

Other features of Dutch arbitration law are the possibility of having multiple arbitrations joined by the President of the Amsterdam District Court. This is extremely useful in multi-party projects, such as construction projects. In addition, the Dutch Civil Code contains the possibility of an arbitral appeal, should such appeal have been agreed by the parties beforehand. (The NAI Rules do not contain provisions referring to an arbitral appeal.) Also, the NAI Rules do not contain the obligation for the tribunal to draft Terms of Reference. However, in a growing number of international arbitrations, the tribunals tend to organize procedural meetings in which documents not dissimilar to Terms of Reference will be drafted and agreed upon.

Apart from the NAI, the Netherlands houses numerous other arbitration institutes, the most important being the Court of Construction Arbitration. This institute by and large is the largest arbitral services provider in the Netherlands. However, its focus is completely on construction and engineering related cases. It does take international arbitrations, to which it applies longer terms for submission of certain pleadings.

The Arbitration Act of 1986 was largely based on the UNCITRAL Model Law for arbitration, although these were supplemented by some sophisticated features such as the possibility for arbitral appeal to the extent agreed beforehand (for instance, as part of the rules of an institute), summary proceedings, and the aforementioned possibility of joining arbitral proceedings.

The Arbitration Act is currently under revision. One of the issues is to what extent arbitrators may have the facility to initiate a request for prejudicial questions to the EU Court of Justice. As things stand now, arbitrators do not have the power to do so themselves, while on the other hand they are bound to apply EU law, even if the parties did not invoke it. There are two ways which can be followed to apply EU law for the purpose of resolving the dispute: use by arbitrators of experts on

EU law (insofar as the arbitrators are not experts themselves) and—in a later stage—by the courts, which decide on the annulment of awards on the ground of noncompliance with public order or insufficient reasoning. In the new proposal, the President of the District Court of The Hague may serve as an intermediary between tribunals and the EU Court.

The Netherlands is an arbitration-friendly country: apart from serving as a host for such tribunals as the International Criminal Court, the Yugoslavia Court, the International Court of Arbitration and the International Court of Justice, the legal community is respectful of the rules of international arbitration. In a decision by the Supreme Court regarding the request for annulment of an interim award by an ICC tribunal, the Supreme Court reasoned that the manner in which the ICC Rules are applied by the tribunal are first and foremost within the competence of the tribunal. The annulment procedure based on the Arbitration Act may after all not be used as quasi-appeal proceedings. For that reason the civil judge may, according to the Supreme Court, only interfere in extraordinary cases. The Netherlands are therefore, at least with respect to recognition and enforcement of awards in international arbitrations, not a banana republic.

## **2. Is pre-arbitration discovery allowed; if so, how does it work?**

The Netherlands do not have a system of pre-trial discovery as it is known in certain common law countries. Having said that, the Code of Civil Proceedings includes several methods of pre-trial fact-finding which, with permission of the local district court, are also available in such arbitration proceedings, including hearing of witnesses, appointment of experts, and the visit of sites. In order to be entitled to conduct such pre-trial facilities, one should apply to the court, stating that a possible dispute is pending for which certain evidence needs to be assembled. The facts to be proven need to be pointed out. The court will conduct an examination of witnesses, whereafter counsel for both parties may ask questions, provided such questions follow from the request to conduct the proceedings.

However, in the Netherlands the possibility of document discovery is not possible.

The minutes from the hearings, or the expert reports, could then be made part of the arbitration proceedings by the party who wishes to do so. It is up to the tribunal to use the evidence as it deems fit.

## **3. How long would it take to obtain an award?**

The average time for NAI to process a request for arbitration into an award is nine months. Summary proceedings could take much less time (less than a month)

and, obviously, as in every jurisdiction, arbitrations can be dragged along endlessly.

## **4. Can this award be quashed in your jurisdiction?**

The Netherlands are signatory to the New York Convention. First of all, the court can refuse the enforcement of an arbitral award if, among other less interesting grounds, the arbitral award is not in conformity with public order. The court on the following—not unfamiliar—grounds can annul an award:

- There is no valid arbitration agreement (but only to the extent the party which invokes this ground has done so to no avail in the arbitration proceedings).
- The tribunal has not been appointed in conformity with the rules (but only to the extent the party invoking this ground has not co-operated in appointing the tribunal).
- The tribunal has overstepped its mandate (but only to the extent the party invoking this ground has—once it was aware the tribunal was about to overstep its mandate—brought this to the attention of the tribunal, again to no avail).
- The award has not been motivated by bias.
- The award is not in conformity with public order.

The court can decide to partially annul the award to the extent the award contained certain orders which were not requested, insofar as those orders can be separated from the rest of the award.

## **5. What costs would be involved (internal, external)?**

Costs can be divided into several categories.

First of all, there are the NAI's administration costs. These are calculated on the basis of a scale according to the amount in dispute. The scale ranges from EUR 150 (amount in dispute less than EUR 5,000) to a maximum of EUR 10,000 (amount in dispute greater than EUR 2,000,000).

Then there are the fees and disbursements of the arbitrator(s). The fees are determined on the basis of three criteria: the time spent on the case by the arbitrator(s), based on a pre-arranged hourly rate; the amount in dispute; and the complexity of the case. In practice, the important factors are the number of hours spent by the arbitrator on the case and the hourly rate agreed with the arbitrator in question before his appointment by the secretariat. The arrangements are based on guidelines established by the Governing Board. Hourly rates generally vary between 150 and 500 Euros.

A third category of costs consists of those that are not necessarily incurred in every arbitration, namely, the costs of a secretary (clerk), an expert and an interpreter.

Lastly, there will also be the costs for legal assistance, should a party wish to be represented by counsel. In the Netherlands, the winner of the case has no possibility to recover all internal and external costs incurred. The tribunal generally will allocate the costs based on reasonableness and fairness.

#### **6. Would such award in your opinion be enforceable in New York?**

That depends on the laws of the state of New York and its rules of comity. New York's courts are bound by the ratification by the United States of the New York Convention. See Part IV.A.6 below.

#### **7. Could such claim be accompanied by the freezing of assets or an arrest?**

Yes, as long as such assets are within Dutch territory. Prior to initiating an arbitration proceeding, the claimant may request the president of one of the local courts—where the assets are, the defendant is situated, or, in the absence thereof, where the claimant is situated—to authorize the claimant to seize assets such as bank accounts, real property, movables, ships and airplanes. The defendant may request lifting such arrests in summary proceedings, which generally will be done against proper security (such as a bank guarantee), or when the claim appears *prima facie* to be without validity. Upon the award becoming final, the assets then may be publicly sold.

### **B. Litigation**

#### **1. What courts are available in your jurisdiction?**

Eighteen district courts (divided into small claims/labor/lease courts and regular district courts), five courts of appeal and one Supreme Court. The regular courts and courts of appeal deal with matters of fact and of law. The Supreme Court deals only with matters of law.

#### **2. Is pretrial discovery allowed; if so, how does it work?**

See Part II.A.2 above. The procedures are the same in regard to both arbitration and litigation.

#### **3. How long would it take to obtain a judgment?**

That depends on the workload of the specific court, the “drive” of the counsel, and the complexity of the case: a minimum of eight months for regular cases, up to many years in complex cases, with interim judgments and appeals and appeals to the Supreme Court,

prejudicial proceedings before the EU Court of Justice, and then back again.

In summary proceedings before the president of the district courts in cases where time is of the essence, there may be a wait of only twenty-four hours (or even less) in urgent matters (an order restraining a broadcasting company from airing a certain news piece, for example).

#### **4. How long would it take to obtain an appeal?**

Decisions on appeal can be rendered within one year. However, see Part II.B.3 above.

#### **5. What costs would be involved (internal, external)?**

Apart from lawyers' fees, which in case of a win are not fully recoverable per se (but rather only as a function of the size and complexity of the case), the courts set their admission fees. These may vary between 1,000 and 25,000 Euros.

#### **6. Would such judgment be enforceable in New York?**

Again, that depends upon the laws of the state of New York and its rules of comity in regard to the recognition of foreign judgments. See Part IV.B.6 below.

#### **7. Would such claim be accompanied by the freezing of assets or an arrest?**

See Part II.A. 7 above.

### **III. Arbitration and Litigation in the United Kingdom**

#### **A. Arbitration**

##### **1. What institute would be recommendable in your local jurisdiction?**

The LCIA Arbitration Court (London Court of International Arbitration) ([www.lcia-arbitration.com](http://www.lcia-arbitration.com)) is one possibility.

It is made up of up to thirty-five members, selected to provide and maintain a balance of leading practitioners in commercial arbitration, from the major trading areas of the world. UK membership on the LCIA Court is restricted to twenty-five percent of total membership. Other members include Hungary, Australia, Nigeria, the United States, Tunisia and China.

It is worth referring to the London Maritime Arbitrators Association (the “LMAA”) (<http://www.lmaa.org.uk>). This is an association of practicing maritime arbitrators, one of the objects of which is “to advance and encourage the professional knowledge of London maritime arbitrators and, by recommendation and



advice, to assist the expeditious procedure and disposal of disputes.”

The Chartered Institute of Arbitrators ([www.arbitrators.org](http://www.arbitrators.org)) does not administer arbitrations, but can assist with the choice of arbitrator. The primary objective of its Royal Charter is “to promote and facilitate the determination of disputes by arbitration and alternative forms of dispute resolution.” The institute provides various services including:

- Maintenance of a Register of Arbitrators, panel of Chartered Arbitrators and a Register of expert witnesses.
- Appointment and nomination service of suitably qualified persons to act as arbitrators and mediators.
- Nomination service of expert witnesses.
- Nomination of adjudicators for parties involved in construction disputes.
- Set-up and administration of small claims dispute resolution schemes.

## 2. Is pre-arbitration discovery allowed? If so, does it work?

If the parties consent to pre-arbitration discovery, then it will be allowed. However, it largely depends upon the institution running the arbitration (if any), the parties and the arbitrators themselves. IBA rules on evidence are sometimes used by tribunals for guidance, or the parties agree to use them.

Article 22.1 of the LCIA rules provides that the arbitrators are authorized “to decide whether or not to apply any strict rules of evidence (or any other rules) as to the admissibility, relevance or weight of any material tendered by a party on any matter of fact or expert opinion; and to determine the time, manner and form in which such material should be exchanged between the parties and presented to the Arbitral Tribunal.” (Emphasis added.)

Discovery generally (“disclosure” is the new terminology) is the process of listing documents, in order to help the inspecting party to establish its side of a dispute. Discovery should be distinguished from inspection, the latter being the exercise of looking at the documents that the other side has disclosed.

Section 34(2)(d) of the Arbitration Act 1996 (the “Act”) provides that the tribunal may decide “whether any and if so which documents or classes of documents should be disclosed between and produced by the parties and *at what stage*.” (Emphasis added.) The wide power granted to the tribunal under section 34(2) is subject to any restrictions or extensions of the arbitra-

tor’s powers in the arbitration agreement and of course to the protection against disclosure of privileged documents. Thus the power of the arbitrator under section 34 of the Act is subject to:

- the protection against disclosure of privileged documents;
- the overriding obligation of the arbitrator under section 33 of the Act; and
- the contrary agreement of the parties.

It may sometimes be reasonable to dispense with disclosure and/or to proceed to the inspection stage of the documents. This may save time and costs, in accordance with the arbitrator’s duty under section 33(1) of the Act.

## 3. How long would it take to obtain an award?

The length of arbitration can vary enormously. If both parties want a quick decision, then it is possible to run an arbitration from start to finish in six months. However, several factors, of course, may affect the length of an arbitration. If a party is not cooperative, or the tribunal is weak, or the arbitration clause itself is badly drafted, then the arbitration can last longer than court proceedings.

However, both the Act and the LCIA rules aim to push matters along without undue delay, and thus give wide powers to the arbitrators/tribunals.

## 4. Can an award be quashed?

LCIA rule 26.9 provides, “All awards shall be final and binding on the parties. By agreeing to arbitration under these rules, the parties undertake to carry out any award immediately and without delay.” In addition, the rule provides that the parties “waive irrevocably their right to any form of appeal.”

Accordingly, the parties exclude any right of appeal on the merits to a national court that might otherwise have jurisdiction to hear such an appeal.

The Act supports the LCIA Rules. Under the Act, an arbitral award made in an English seat can only be challenged as of right on the grounds that the tribunal “lacked substantial jurisdiction” or for some “serious irregularity.” If the “substantial jurisdiction” argument is put forward, then the court can confirm, vary or set aside the award in whole or part. “Serious irregularity” includes the tribunal exceeding its powers, failure by the tribunal to deal with all the issues that were put to it, and uncertainty or ambiguity as to the effect of the award. The court has the power to remit the award to the tribunal, in whole or part, for reconsideration; to set the award aside in whole or in part; and to declare the award to be of no effect in whole or in part.

There is no power to intervene where the complaint is that the arbitrator has made an error of fact. And it is not necessarily enough that the arbitrator has made an error of law, for there is no right of appeal without leave: leave will only be given in a limited class of cases. However, the courts may intervene where there has been an error of procedure which could lead to an unjust result (“procedural mishap”).

An appeal on a point of law is regulated by section 69 of the Arbitration Act. The right of appeal is limited to cases where the parties have not made an exclusion agreement (an agreement to dispense with the giving of reasons in an award) as under section 69(1) of the Act.

Appeal is only possible with leave unless all parties agree. Under section 69(3) of the Act, leave will only be granted if the court is satisfied that:

- The determination of the question will substantially affect the rights of one or more of the parties;
- The question is one which the tribunal was asked to determine;
- On the basis of the findings of fact in the award—
  - (i) The decision of the tribunal on the question is obviously wrong, or
  - (ii) The question is one of general public importance and the decision of the tribunal is at least open to serious doubt, and
- Despite the agreement of the parties to resolve the matter by arbitration, it is just and proper in all the circumstances for the court to determine the question.

Under section 70(2) of the Act, in order to appeal, the applicant must first have exhausted any available arbitral process of appeal or review, and any available recourse under section 57 of the Act (correction of an award or an additional award) providing that the appeal must be brought within twenty-eight days after the award, and the court may order the applicant to provide security pending the outcome of the appeal.

If the court hears an appeal, it will either

- confirm the award;
- vary it;
- remit the award to the tribunal for reconsideration in whole or in part; or
- set aside the award in whole or in part.

There is little authority on the principles to be applied in deciding whether to remit the award or set it aside. In practice, an order for setting aside the award,

without remitting it, is rare. In a case titled *Windvale v. Darlington Insulation Company*, Judge Walton decided to set aside, rather than remit, the award, on the ground that the arbitrator had gone wrong so fundamentally at almost every stage that the arbitration should start again with a clean slate. The case was sufficiently unusual to merit comment in *The Times* of 22 December 1983. Generally however, where only a small part of the findings of the arbitrator are successfully challenged and there is no serious irregularity, then remission is more appropriate.

## 5. What costs would be involved (internal, external)?

Costs in an LCIA arbitration would include a registration fee of £1,500 (payable on filing the request for arbitration), and thereafter, hourly rates as applied by the LCIA and its arbitrators. Note that one advantage of LCIA arbitration is that the LCIA does not claim a percentage of the settlement.

Arbitration under the auspices of the London Maritime Arbitration Association is viewed as fast and low-cost arbitration, because a single arbitrator is used, not a tribunal, and there are generally no oral hearings.

Among the other costs a party would incur in any arbitration are legal fees and disbursements for legal advisors, the fees and disbursements of the arbitrators, and the costs of experts, if experts are needed.

## 6. Would such an award in your opinion be enforceable in New York?

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (“The New York Convention”) simplifies the procedure for the recognition and enforcement of foreign arbitral awards between contracting states. Both the UK and the USA have acceded to it, and are deemed “Contracting States,” so the award is enforceable in the USA. Note that, although the awards are enforced in accordance with the rules of procedure in the territory where the award is being enforced, the enforcement should be no more onerous than that for domestic arbitration awards.

However, under Article V of the Convention, enforcement can be resisted. Arguments include invalid arbitration agreement, lack of due process and invalid composition of arbitral tribunal. It should be noted that in the US the enforcing court *may* deny enforcement, but is not required to deny it, even if the grounds under Article V are given.

If a party fails to comply with an award against it, the successful party can rely on the provisions of the New York Convention. The award will be enforceable in New York, since the arbitration took place in a Convention State (that is, the UK) and the enforcement is

against assets of the losing party which are located in another Convention State (namely, the United States).

## 7. Could such a claim be accompanied by the freezing of assets or an arrest?

Under section 44 of the Act, a court can make an *ex parte* freezing order in order to preserve assets in support of an arbitration, whether or not the arbitration has in fact commenced. The only constraint on this ability is set out in section 44(5), to the effect that the court can only act in cases “if or to the extent that the arbitral tribunal . . . has no power or is unable for the time being to act effectively.”

The Arbitration Act has been reviewed and interpreted by the courts. Pursuant to the case of *Petroleum Investment Company Ltd v. Kantupan Holdings Co Ltd*, [2002] 1 All ER (Comm) 124, a court would consider the following issues as a test when it was deciding whether to grant a freezing injunction:

- Did the claimant have an arguable case for an accrued action against the defendant?
- If so, was the matter one of urgency as demanded by section 44 of the Act?
- Was there a risk that the defendant would dissipate its assets in advance of any arbitration award?

An application for a freezing order could be made either with or without prior notice to the other party: to make it without notice the applicant would need to explain to the court why it was making the application without notice (for example, assets would be dissipated before the injunction could be obtained if on notice). The application would further have to:

- disclose all material facts to the court (including any prejudicial evidence); and
- give a cross undertaking in damages.

A failure to make full and frank disclosure would lead to the discharge of the injunction.

If the injunction is granted before the arbitral proceedings have started (or in this case where it is at the beginning of the arbitral process), the court will generally make a direction (or require an undertaking) for the proceedings to be started by a specified day and time. Generally, the freezing injunction will remain in effect for as long as required.

The court will generally only grant a freezing injunction if the applicant can satisfy the court that the respondent has assets within the jurisdiction.

## B. Litigation

### 1. What courts are available in your jurisdiction?

Civil proceedings in England and Wales may be conducted in magistrate’s courts, county courts and the High Court. A dispute would be issued out of the High Court, if the money claim is over the value of £15,000. Appeals in civil matters are taken to the Court of Appeal, Civil Division and the House of Lords.

A wide range of civil disputes are also determined by various tribunals, including employment tribunals and social security tribunals.

### 2. Is pre-trial disclosure allowed; if so, how does it work?

Disclosure before an action is commenced is allowed, and indeed the early exchange of information is encouraged. The procedure for applying for the disclosure of documents before proceedings have started is governed by CPR 31.16:

- An application for pre-action disclosure must be supported by evidence (CPR 31.16(2)).
- The court may make an order for such disclosure only where the applicant and respondent are likely to be parties to subsequent proceedings (CPR 31.13(3)(a) and (b)).
- The applicant must establish a worthwhile claim or a reasonable basis for the intended claim.
- An order will be made only if, had proceedings been started, the respondent’s duty by way of standard disclosure (CPR 31.6) would extend to the documents or to classes of documents of which the applicant seeks disclosure (CPR 31.16(3)(c)).

CPR 31.16(3)(d) states that the court may only make an order for pre-trial disclosure, to:

- dispose fairly of the anticipated proceedings; and
- to assist the dispute to be resolved without proceedings; or
- to save costs.

Pre-action disclosure will therefore only be permitted if it satisfies the court that the document sought is disclosable, and that disclosing it *at that stage* will further one of the purposes set out in CPR 31.13(3)(d). It may be interesting to note that where pre-action protocol applies, the need for such applications is reduced, as protocols normally provide for the early exchange of documents and information before a claim is issued.

Most applications for pre-action disclosure are made on behalf of the potential claimant. The rules on

costs relating to special cases (CPR Part 48) apply to pre-action disclosure and applications for disclosure against non-parties. The general rule, set forth in CPR 48.1(2), is that the person against whom an order for pre-action disclosure is sought will be awarded the costs of the application and of complying with the order made. As with all cost orders, the court will have regard to the general duty of cooperation between the parties and reasonableness of their conduct.

Once proceedings have commenced, parties are under a duty to disclose a document by stating that the document exists or has existed. The duty of standard disclosure requires a party to disclose only those documents which he is required to disclose by a relevant practice direction, those documents on which he relies and those documents which:

- adversely affect his own case;
- adversely affect another party's case; or
- support another party's case.

When giving standard disclosure, a party is required to make a reasonable search for those documents required to be disclosed for standard disclosure. This duty is limited to documents which are or have been in the party's control.

The procedure for disclosure once proceedings have been commenced is governed by CPR 31.10. Each party must make and serve on every other party, a list of documents which identifies the documents in a convenient order and manner. The list must indicate those documents which the party claims a right or duty to withhold inspection and those documents no longer in the party's control.

The list must also include a disclosure statement made by the disclosing party which (i) sets out the extent of the search that has been made to locate the documents, (ii) states that he understands the duty to disclose documents, and (iii) certifies that to the best of his knowledge he has carried out that duty.

Each party then has a right to inspect those documents which have been disclosed to them unless the document is no longer in the control of the other party or the disclosing party has a right or a duty to withhold inspection.

Under CPR 31.11, any duty of disclosure continues until the proceedings are concluded, so that if documents to which that duty extends come to a party's notice at any time during the proceedings, he must immediately notify every other party of it.

### **3. How long would it take to obtain a judgment?**

Litigation takes time, both through the investigative stages before proceedings are commenced and after

issue through to the final resolution. A few years is a fair estimate, but it can be achieved very quickly if both parties agree or if the court takes the view that it should be resolved urgently. A court judgment can be obtained in three ways:

- Judgment in default pursuant to CPR Part 13: This can be obtained within usually fourteen days or twenty-eight days after service of the particulars of the claim.
- Summary judgment pursuant to CPR Part 24: An application is made to the court once the defendant has filed an acknowledgment of service indicating an intention to defend. The hearing of this application usually takes less than a day of court time and is likely to be heard in approximately four to six weeks after issue of the application.
- Trial judgment: This is dependent on various factors, including the service of statements of case, disclosure, witness/expert evidence and estimated length of trial, but usually within twelve to twenty-four months after issue of a claim form.

### **4. How long will it take to obtain an appeal?**

Pursuant to CPR 52.4(2)(b), an appellant must normally initiate an appeal no later than fourteen days from the date of the decision of the lower court. Note CPR 3.1 (2)(a), which reserves the right for the court to extend or shorten the time for compliance with any rule, practice direction or court order. Moreover, pursuant to CPR 52.4(2)(a), the lower court may direct some other period for filing a notice of appeal, although this should not normally be longer than twenty-eight days.

Note that, pursuant to CPR 40.7(1), judgments and orders take effect from the date they are given or made, or such other date as the court may specify.

### **5. What costs would be involved (internal, external)?**

Litigants are bound to meet the legal cost of the advice given by and the work done by their solicitors. However, the English courts do have a wide discretion to order one litigant to contribute toward the cost of another. As for funding litigation, conditional fee arrangements are permitted under sections 58 and 58A of the Courts and Legal Services Act 1990. This is defined by section 58(2)(a) as an agreement with a person providing advocacy or litigation services which provides that the lawyer's fees and expenses, or any part of them, will be payable only in specified circumstances. The parties must inform each other in pre-action stages whether they are being funded under such an arrangement.

The costs of litigation include (i) fees payable to one's own solicitors and barristers; (ii) disbursements incurred on behalf of a party (such as court fees, fees payable to expert witnesses); and (iii) general disbursements (fares and the cost of photocopying documents). These costs are payable irrespective of the result of the proceedings, and are invoiced by a party's solicitors and payable by agreement in the normal way.

Nevertheless, the court has a wide discretion to order that one litigant should contribute to another's costs. Cost orders will include all of the costs "of or incidental to" the proceedings. Generally, an order will be made that costs of the proceedings are paid by the loser to the winner. This is known as "costs follow the event."

During the course of the litigation proceedings, but before the trial itself, the parties usually attend court to apply for interlocutory applications. At each of these applications, the court will make an order as to costs. The most common costs are costs reserved (the party in whose favor an order for costs is made at trial is entitled to be reimbursed in the costs of this interlocutory application unless the court orders otherwise) and costs in any event (the party in whose favor the order is made is entitled to be reimbursed the costs of this application whatever the outcome of the case).

It will not usually be open to the parties to quantify the costs payable and enforce the order until after the trial or compromise of the action. Therefore, recoverable costs will normally only be reimbursed after the end of the litigation, which may be two, three or even more years after the payment of interim invoices.

It should be noted that an order for costs does not necessarily entitle the winner to be reimbursed all of the costs which it has paid or owed to its solicitor. If the costs to be reimbursed can not be agreed as between the parties, they will be carried out on one of two bases: the standard or the indemnity basis. The costs as between parties are generally assessed on the standard basis, whereby the court will allow all costs that are reasonable in amount and reasonably incurred. Recently up to eighty-five percent of the costs of litigation have been received, although two-thirds is more usual. The indemnity basis is used as a penalty for abuse of the process and is made in favor of the receiving party. However, it should be noted that it is almost impossible to be fully reimbursed.

Thus, the English system helps litigants to balance the chances of success with the risks of failure, since it gives the parties the benefit of the sight of all the evidence to be adduced by the opposition prior to trial, but this obviously entails escalating costs.

## **6. Would such judgment be enforceable in New York?**

The United States is not a party to any international convention governing the recognition and enforcement of foreign judgments. Enforcement of judgments issued by foreign courts in the United States is governed by the laws of the states, as discussed in Part IV.B.6 below. An individual seeking to enforce a foreign judgment, decree or order in one of the United States must "file suit" before a competent court. The court will determine whether to give effect to the foreign judgment. As with most legal proceedings, it is necessary to retain legal counsel to conduct the "suit."

In the U.S. federal and state courts, it is necessary to start an action on the judgment in much the same way as judgments are enforced at common law in England. In New York, a summary judgment procedure is available. The court may, but usually does not, reassess the merits of the case, depending on the state's rules of private international law.

At the suggestion of the U.S. delegation, the Hague Conference on Private International Law agreed in 1992 to begin work on a multilateral judgments convention, the Convention on Jurisdiction and the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters. In the meantime, the enforcement of an English judgment in the USA is subject to the laws of the USA, and advice from lawyers practicing in that jurisdiction will be required before dealing with any proposed enforcement.

## **7. Could such a claim be accompanied by the freezing of assets or an arrest?**

A freezing injunction tries to prevent the injustice of a defendant's assets being dissipated, so as to deprive the claimant of the value of a judgment that may be obtained. A freezing injunction pursuant to CPR 25.1(1)(f) is an interim order restraining a party from removing assets located within the jurisdiction out of the country, or from dealing with assets whether they are located within the jurisdiction or not. It is a relief in personam, which prevents certain acts in relation to the assets frozen.

Usually the order will be restricted to assets not exceeding the value of the claim. It should be noted, however, that the jurisdiction to grant freezing injunctions has not changed the law of insolvency, and the imposition of such an order does not give the claimant any priority or security if the defendant becomes insolvent.

Freezing orders will only be granted if a number of onerous conditions are fulfilled. The most important condition is that there must be a real risk that the defendant will dissipate assets to frustrate any judgment the

claimant may obtain. As to where to apply for a freezing injunction, county courts do not generally have jurisdiction to grant freezing injunctions, so applications must usually be made in the High Court pursuant to County Court Remedies Regulations 1991 reg 3(1). However, there are a few exceptions, so that freezing injunctions may be granted by a county court where a High Court or Court of Appeal judge sits.

Regarding procedure, the application is made without informing the defendant, so it is made to a judge sitting in private. The application is usually made before service of the claim form, and must be supported by an affidavit making full and frank disclosure of all material facts, including those going against the grant of the order. Counsel must produce a draft minute of the order sought. Where possible, the papers must be delivered to the court at least two hours before the hearing, to allow the judge to read them in advance.

The jurisdiction to grant freezing injunctions derives from the Supreme Court Act 1981. The following conditions must be met:

- A cause of action that is justiciable in England and Wales, that is, the claimant must have a substantive cause of action which can be brought in England and Wales.
- The client must have a good arguable case.
- The defendant must have assets within the jurisdiction.
- There must be a real risk that the defendant may dissipate those assets before judgment can be enforced.

Worldwide freezing injunctions may also be granted by the court. Such an injunction may be granted:

- Where the defendant has acted dishonestly or fraudulently on a large scale;
- The defendant has the ability to transfer large sums of money around the world quickly; and
- The defendant is able to hide assets behind companies or in countries where they are unlikely to be found.

## **IV. Arbitration and Litigation in the United States**

### **A. Arbitration**

#### **1. What institute would be recommendable in your local jurisdiction?**

The American Arbitration Association (“AAA”), with headquarters in New York, is one arbitration association which has national standing. It tends to be fairly

efficient, and its fees tend to be cheaper than those of the International Chamber of Commerce. It has offices in most major American cities. It has a variety of arbitration rules, but the ones most commonly used in contract matters are the Commercial Arbitration Rules, although the AAA also has International Rules. The AAA website at [www.adr.org](http://www.adr.org) includes all the various arbitration rules of the Association.

Two tips regarding the use of the AAA:

(a) It is probably best to place the arbitration in a large American city, such as New York, Chicago or Los Angeles, in order to assure that there is a large pool of qualified local arbitrators on the AAA arbitration list.

(b) It certainly is permissible to qualify your arbitrators within the arbitration clause, that is, listing specifically the qualifications that you would like for the arbitrators to have, such as licensed attorneys or so many years of experience in negotiating contracts of a certain type, or engineering background, etc.

#### **2. Is pre-arbitration discovery allowed; if so, how does it work?**

The various AAA arbitration rules do not expressly provide for extensive litigation-style discovery. But pre-arbitration discovery (meaning discovery after the arbitration has been commenced but before a main arbitration hearing is held) is permitted, and can be called for in a contractual arbitration clause. Alternatively, the parties can agree on discovery procedures with the arbitrator at the start of the arbitral proceedings.

Arbitration discovery generally is patterned on pre-trial discovery, with supervision being provided by the arbitrators, but usually arbitration discovery is not as extensive (either in duration or scope) as litigation discovery.

Indeed, it can be difficult to avoid pre-arbitration discovery in U.S. arbitration, even if one selects the International Rules of the AAA, where one would expect a documentary procedure more in line with litigation in Europe or ICC arbitration: Since most American arbitrators have almost exclusively experience with American litigation, they are inclined to permit discovery of some sort or another, including requests for production, interrogatories, and even depositions. Obviously, this often works to the advantage of a plaintiff, even if the plaintiff is foreign.

#### **3. How long would it take to obtain an award?**

Theoretically, one could obtain a final arbitral award within ninety to one hundred twenty days, but given the complexity of most matters that are arbitrated, and in light of the discovery process as well as the need to find hearing dates which are convenient to not

only the parties but also the arbitrators, one should anticipate arbitrations taking six to twelve months.

#### **4. Can this award be quashed in your jurisdiction?**

The Federal Arbitration Act, which regulates the recognition of arbitration awards within both the federal and state court systems when maritime transactions or commerce between the states or with foreign nations is involved, does allow some grounds for attacking arbitral awards. Those grounds, which appear at 9 U.S.C. § 10(a) and are set forth on Appendix A-1 hereto, are in some respects (such as clause (3) of 9 U.S.C. § 10(a) somewhat broader than the grounds on which one could base an attack on a foreign arbitration award, such as under Article V of the New York Convention, which appear on Appendix A-2 hereto. In addition, 9 U.S.C. § 11 empowers the court to modify the award:

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

Section 11 also states generally that “The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.”

To the extent that the FAA does not apply, the arbitration law of a particular state will regulate the recognition of an arbitration award. In New York, that law is Civil Practice Law and Rules (CPLR) Article 75. CPLR section 7511 contains the grounds for vacating and modifying an arbitration award (with the grounds for modification being identical to those in the Federal Arbitration Act), and they are set forth on Appendix B hereto.

Nevertheless, the quashing of arbitral awards is fairly rare. New York courts are especially reluctant to overturn arbitration awards. Moreover, in connection with recognizing *foreign* arbitration awards, the recognition standard of the New York Convention would apply, as specifically acknowledged in 9 U.S.C. § 201 of the Federal Arbitration Act.

#### **5. What costs would be involved (internal, external)?**

The AAA has a schedule of arbitration fees, which are based upon the size of the dispute in controversy. Indeed, the fees must be paid in order to commence the arbitration or to participate in the arbitration by filing a

response. Nevertheless, these fees tend to be lower than those of the ICC.

In addition, there are the fees and expenses of the arbitrators, as well as one’s own attorneys and other expert fees. Depositions result in the additional expense of stenographers. To the extent that the arbitration will be held in the United States, it is probably wise within the arbitration clause to state whether attorneys’ fees of the prevailing party are to be reimbursed, since the standard “American rule” of litigation procedure is that each party is to pay its own attorneys’ fees, regardless of who is the prevailing party, unless otherwise specified by certain statutes (such as civil rights and anti-discrimination statutes) or by contract.

#### **6. Would such an award in your opinion be enforceable in New York?**

To the extent that this is a domestic arbitration proceeding, the likelihood of enforcement is great.

Indeed, if judgment is entered on the award in the court system of any of the fifty states of the United States, each other state is required to give full faith and credit to such judgment pursuant to the United States Constitution’s provisions regulating relations between the various states.

In addition, since the United States has ratified the New York Convention, such treaty law in regard to the recognition of foreign arbitration awards becomes part of the law of the state of New York.

#### **7. Could such a claim be accompanied by the freezing of assets or an arrest?**

Attachment of assets pending arbitration or some other resolution of the dispute between the parties would only be possible by separate judicial action. In New York, pre-judgment attachments, whether in regard to judicial proceedings or arbitral proceedings, are regulated by CPLR Article 62. (CPLR 7502(c) permits New York judges to issue injunctions or attachments under CPLR Article 62 in connection with arbitral proceedings, if the plaintiff can convince the judge that the arbitration award may be rendered ineffectual without provisional relief such as attachment.)

The grounds for attachment are set forth in CPLR 6201, set forth below as Appendix C. Basically, if the defendant is a New York domiciliary or is qualified as a foreign corporation to do business in the state and has been served process, attachment is possible, but if the defendant has given no indication of an effort to defraud creditors or otherwise secrete assets, attachment may be difficult to obtain. In any event, the plaintiff will almost surely have to post a bond, and the court that is petitioned to issue an attachment order, even if it does so on an *ex parte* basis initially, will with-

in a certain period of time hold a hearing at which the defendant will be allowed the opportunity to convince the judge that attachment is not appropriate.

## **B. Litigation**

### **1. What courts are available in your jurisdiction?**

In each state of the United States there are two entirely separate legal systems: the federal court system and the court system of the specific state. The state court system will have trial courts of the first instance, as well as at least one automatic appeal level, and the federal court system will have at least one trial court of the first level and the right for an automatic appeal to an appellate court, which may well sit outside the particular state, but covers all federal appeals from within that state. Often a second appeal, to either the supreme court of the particular state or to the United States Supreme Court, is at the discretion of the relevant supreme court. (In New York, the highest appellate court is called the Court of Appeals, while the trial courts of first instance are called, strangely enough, supreme courts.)

The jurisdiction of the federal courts is limited by the U.S. Constitution and the laws of Congress, and it is certainly possible that in a particular instance a plaintiff may only avail itself of the state court system, because jurisdiction is not available in the federal courts. The most common grounds for jurisdiction of commercial disputes within the federal courts is the so-called diversity of citizenship, where the citizenship of all the plaintiffs is different from the citizenship of all of the defendants. In addition, the amount that is in controversy (*Streitwert*) must be at least \$75,000.

It is possible for the defendants in a lawsuit brought within the state court system to remove the case to the federal courts, as long as the federal jurisdictional prerequisites would in fact be met (e.g., diversity of citizenship and at least \$75,000 in dispute), but such removal petitions must normally be filed within thirty days after service of process in the state court case.

### **2. Is pretrial discovery allowed; if so, how does it work?**

Both the federal and state court systems allow pre-trial discovery, which is essentially carried out by the attorneys for the parties, with only loose supervision by the court itself. Generally, the court only intervenes if there is a dispute between the parties or if an enforcement of discovery procedures against one of the parties is necessary.

### **3. How long would it take to obtain a judgment?**

The amount of time needed in order to obtain a trial frequently depends on where the lawsuit has been

brought, since the dockets of pending cases in various states and even within various jurisdictions in various states can vary significantly.

Nevertheless, the general rule of thumb is that it takes less time to achieve a trial date within the federal court system than within the state court system. In any event, one should assume that it will take at least one to two years to obtain a trial in either the federal or state court systems.

### **4. How long would it take to obtain an appeal?**

Once again, the answer to this question may well depend on the jurisdiction in which the case is pending. Generally speaking, oral argument before the appellate court (to the extent oral argument is permitted) will usually take place within three to nine months after the appeal is filed and all briefs have been filed, but the time period between when the notice of appeal is filed (which usually must be within thirty days after the trial judgment is entered) and the filing of all briefs can be anywhere from six to nine months. In any event, in almost all instances there is no requirement on the appellate court to issue its opinion within a specified time after the oral argument, and in some instances the wait for the decision can be lengthy.

### **5. What costs would be involved (internal, external)?**

Generally, court costs are not significant, and filing fees are not graduated on the basis of the amount in controversy. Of course, reproduction costs and stenographer's fees in regard to production of documents or depositions during discovery can be significant.

And, of course, attorneys' fees in American litigation frequently are quite significant for at least two reasons: (i) The discovery process frequently demands enormous amounts of time from the attorneys, and (ii) the nature in which trials are conducted in the United States, with the attorneys in fact carrying out all of the examination and cross-examination of witnesses (to say nothing of preparing the witnesses for their testimony) results in trials within the United States being very labor-intensive and very expensive.

As noted above, generally each party is required to bear its own attorneys' fees and costs, regardless of which is the prevailing party, unless the parties have provided otherwise by contractual agreement or there is some particular statute which provides that the prevailing party is to receive reimbursement of attorneys' fees and disbursements. Generally speaking, such fee-shifting provisions are found in various federal statutes regulating wrongdoing such as discrimination, and are usually of little relevance in cases involving ordinary commercial or contract disputes.



## 6. Would such a judgment be enforceable in New York?

To the extent that the judgment is obtained within one of the fifty states, then the judgment is entitled to full faith and credit under the Constitution of the United States.

To the extent that a judgment is a foreign judgment, it is ironic that the United States has ratified the New York Convention on the recognition of foreign arbitration awards, but has not entered into any treaty or convention in regard to the recognition of foreign judgments. As a result, recognition of foreign judgments within the state and federal court systems is on the basis of comity, although usually the comity analysis conducted by state and federal judges in the United States is similar to the analysis that one would expect from courts in foreign jurisdictions. There is some disagreement among U.S. courts whether, once a foreign judgment has been recognized by one of the fifty United States and thereby become a judgment of one of the fifty states, such judgment will be treated as a domestic judgment if recognition is sought in another of the fifty states, entitled to full faith and credit under the U.S. Constitution as a judgment of another state, or will instead still be viewed as a foreign judgment, subject still to comity analysis. *See, e.g., Reading & Bates Constr. Co. v. Baker Energy Res. Corp.*, 976 S.W.2d 702 (Tex. Ct. App. 1998).

In any event, New York has enacted the Uniform Foreign Country Money-Judgments Recognition Act, which is codified at CPLR Article 53. The grounds for non-recognition are set forth at CPLR 5304, which is set forth as Appendix D hereto, and reflect much of what would be a typical comity analysis. Nevertheless, the grounds for failing to recognize a foreign *judgment* under CPLR 5304 are somewhat broader than those grounds for non-recognition of foreign *arbitral awards* contemplated by Article V of the New York Convention.

## 7. Would such claim be accompanied by freezing arrests of assets in your jurisdiction?

As noted above in Part IV.A.7, the grounds for pre-judgment attachment are going to be the same, whether in the context of pre-arbitration or pre-judgment proceedings. As noted, a hearing at which the defendant may appear to contest the attachment will be required, and a bond may need to be posted.

**Ms. De Roeck is a partner in the Brussels office of Loyens Advocaten; Mr. van Wassenaer is a partner in the Amsterdam office of Norton Rose; Ms. Blanch is a partner in the London office of Norton Rose; and Mr. Detjen is a partner in the New York office of Alston & Bird LLP.**

## APPENDIX A-1

### 9 U.S.C. § 10(a)

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.

**CONVENTION ON THE RECOGNITION  
AND ENFORCEMENT  
OF FOREIGN ARBITRAL AWARDS**

**Article V**

1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

(a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

(c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(d) the composition of the arbitral authority or the arbitral procedures was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement of arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country.

**NEW YORK CPLR 7511**

**7511. Vacating or modifying award**

(a) **When application made.** An application to vacate or modify an award may be made by a party within ninety days after its delivery to him.

(b) **Grounds for vacating.**

1. The award shall be vacated on the application of a party who either participated in the arbitration or was served with a notice of intention to arbitrate if the court finds that the rights of that party were prejudiced by:

(i) corruption, fraud or misconduct in procuring the award; or

(ii) partiality of an arbitrator appointed as a neutral, except where the award was by confession; or

(iii) an arbitrator, or agency or person making the award exceeded his power or so imperfectly executed it that a final and definite award upon the subject matter submitted was not made; or

(iv) failure to follow the procedure of this article unless the party applying to vacate the award continued with the arbitration with notice of the defect and without objection.

2. The award shall be vacated on the application of a party who neither participated in the arbitration nor was served with a notice of intention to arbitrate if the court finds that:

(i) the rights of that party were prejudiced by one of the grounds specified in paragraph one; or

(ii) a valid agreement to arbitrate was not made; or

(iii) the agreement to arbitrate had not been complied with; or

(iv) the arbitrated claim was barred by limitation under subdivision (b) of section 7502.

(c) **Grounds for modifying.** The court shall modify the award if:

1. there was a miscalculation of figures or a mistake in the description of any person, thing or property referred to in the award; or

2. the arbitrators have awarded upon a matter not submitted to them and the award may be corrected without affecting the merits of the decision upon the issues submitted; or

3. the award is imperfect in a matter of form, not affecting the merits of the controversy.

## APPENDIX C

### NEW YORK CPLR 6201

#### 6201. Grounds for attachment

An order of attachment may be granted in any action, except a matrimonial action, where the plaintiff had demanded and would be entitled, in whole or in part, or in the alternative, to a money judgment against one or more defendants, when:

1. the defendant is a nondomiciliary residing without the state, or is a foreign corporation not qualified to do business in the state; or
2. the defendant resides or is domiciled in the state and cannot be personally served despite diligent efforts to do so; or
3. the defendant, with intent to defraud his creditors or frustrate the enforcement of a judgment that might be rendered in plaintiff's favor, has assigned, disposed of, encumbered or secreted property, or removed it from the state or is about to do any of these acts; or
4. the action is brought by the victim or the representative of the victim of a crime, as defined in subdivision six of section six hundred twenty-one of the executive law, against the person or the legal representative or assignee of the person convicted of committing such crime and seeks to recover damages sustained as a result of such crime pursuant to section six hundred thirty-two-a of the executive law; or
5. the cause of action is based on a judgment, decree or order of a court of the United States or of any other court which is entitled to full faith and credit in this state, or on a judgment which qualifies for recognition under the provisions of article 53.

## APPENDIX D

### NEW YORK CPLR 5304

#### 5304. Grounds for non-recognition

**(a) No recognition.** A foreign country judgment is not conclusive if:

1. the judgment was rendered under a system which does not provide impartial tribunals or procedures compatible with the requirements of due process of law;
2. the foreign court did not have personal jurisdiction over the defendant.

**(b) Other grounds for non-recognition.** A foreign country judgment need not be recognized if:

1. the foreign court did not have jurisdiction over the subject matter;
2. the defendant in the proceedings in the foreign court did not receive notice of the proceedings in sufficient time to enable him to defend;
3. the judgment was obtained by fraud;
4. the cause of action on which the judgment is based is repugnant to the public policy of this state;
5. the judgment conflicts with another final and conclusive judgment;
6. the proceeding in the foreign court was contrary to an agreement between the parties under which the dispute in question was to be settled otherwise than by proceedings in that court; or
7. in the case of jurisdiction based only on personal service, the foreign court was a seriously inconvenient forum for the trial of the action.

(Added L.1970, c. 9081, § 1.)

# Obtaining Evidence in Canada for Use in Foreign Proceedings: Principles and Practice

By Peter Balasubramanian and Cynthia Tape

## I. Overview

The principle of international comity, as embodied in bilateral conventions and national statutes, has been judicially recognized in Canada as the basis on which Canadian courts will provide assistance to foreign courts seeking to obtain evidence in Canada. According to the classic statement of Dickson J. (as he then was) in *Zingre v. The Queen*:

It is upon this comity of nations that international legal assistance rests. Thus the courts of one jurisdiction will give effect to the laws and judicial decisions of another jurisdiction, not as a matter of obligation but out of mutual defence and respect. A foreign request is given full force and effect unless it be contrary to the public policy of the jurisdiction to which the request is directed . . . or otherwise prejudicial to the sovereignty of the citizens of the latter jurisdiction.<sup>1</sup>

International judicial cooperation is more important now than ever before, as requests from foreign litigants seeking evidence, both documentary and oral, from witnesses residing in Canada become increasingly common. In this article, we review how foreign parties can obtain evidence from witnesses in Canada by using international conventions, national statutes and common law principles.

## II. Obtaining Evidence for Use in Foreign Proceedings

### A. Voluntary Evidence

There is no general prohibition against the taking of evidence from a voluntary witness in Canada for foreign proceedings. Before consideration is made of the various ways in which a Canadian resident can be compelled to give evidence in a foreign proceeding, therefore, it should first be determined whether the evidence may be given voluntarily. Simply asking for an opportunity to take the evidence of the witness may be sufficient.<sup>2</sup> It should be noted, however, that where a foreign official will preside over the taking of voluntary evidence, the practice of Canada's Department of Foreign Affairs and International Trade (DFAIT) has been to require assurances as to the voluntary nature of the examination.<sup>3</sup>

It is also possible that the desired information can be obtained without examining any witness at all. Thus the public availability of information should be considered for specific types of evidence. For example, subject to applicable privacy and access to information laws, a court order is not needed to obtain access to motor vehicle registrations, real property registration records, some forms of personal property security searches, and bankruptcy information.<sup>4</sup>

### B. Evidence Taken Under Compulsion

Where the evidence sought by a foreign party cannot be obtained through the cooperation of the Canadian resident or through publicly available information, methods of compelling the evidence must be considered. These methods include using the various evidence conventions to which Canada is a signatory, and the mechanisms set up by Canada's domestic evidence statutes permitting the enforcement of letters of request from foreign courts.

#### 1. Evidence conventions

##### a. Hague Evidence Convention

The most significant international convention facilitating the obtaining of evidence in foreign jurisdictions is the 1970 *Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters* ("Hague Evidence Convention"). The Hague Evidence Convention codifies procedures for obtaining and enforcing letters of request for its various signatories, which include the United States and the United Kingdom. Canada, however, has not acceded to the Hague Evidence Convention and therefore it is not used for the purpose of enforcing letters of request or letters rogatory seeking evidence from Canadian residents.

##### b. Bilateral evidence conventions

Although not party to the Hague Evidence Convention, Canada is a party to certain bilateral evidence conventions that deal with the taking of evidence between Canada and the treaty state. No evidence convention exists with the United States, however. Since the vast majority of letters of request in Canada deal with requests coming from the United States, the majority of cases, texts and academic articles dealing with letters of request tend to ignore the relevance of Canada's bilateral evidence conventions. Nonetheless, where an evidence convention does apply (i.e., where the requesting party resides in a state that is a signatory to an evidence

convention with Canada), its requirements should be considered.

The evidence conventions themselves originated from extension of treaties entered into by Great Britain in the 1920s and 1930s, and apply to a number of countries, including Austria, Belgium, the former Czechoslovakia, Denmark, Finland, France, Germany, Greece, Hungary, Iraq, Italy, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Turkey and the former Yugoslavia. If an evidence convention is in force, it will be recognized by Canadian courts and given a fair and liberal interpretation with a view to fulfilling Canada's international obligations. To avoid any uncertainty about the enforceability of a convention, however, courts have recommended that counsel obtain affidavits from both the Registrar of the Treaty Section of Canada's DFAIT and the other state attesting to the convention's enforcement in each country.<sup>5</sup>

Generally, the evidence conventions provide for two alternative means of obtaining evidence: (1) voluntarily by consular authority; and (2) compulsorily by letters of request. These means are described below.

#### **(i) Evidence taken by consular authority**

Where the person whose evidence is sought will cooperate, the conventions permit the requesting consular authority to take the evidence in Canada in accordance with the laws of the consular authority's country.

For example, article 11 of the convention between Canada and Germany provides that evidence may be taken without the intervention of Canadian authorities if the citizen from whom the evidence is sought consents to give evidence. In this case, article 11(c) provides that "the evidence may be taken in accordance with the procedure laid down by the law of the country in which the evidence is to be used." Where the prospective witness is not willing to cooperate and is a citizen of the *requesting* state, some conventions permit the consular authority to request a Canadian court to compel the witness to attend to give evidence. Again, the evidence will be taken in accordance with the laws of the country in which it is to be used.

#### **(ii) Evidence taken by letters of request under an evidence convention**

Letters of request issued pursuant to an evidence convention should conform to the procedures specified in the convention. While there is no clear expression in the case law that the procedures set out in the conventions are mandatory (Canadian courts have enforced requests by convention signatories even where the convention's procedures have not been followed), the prudent course is to comply with the procedures set out in the applicable convention. Generally, letters of request must include (i) a description of the nature of the for-

eign proceeding; (ii) the full names of the parties; (iii) the full names and addresses of the witnesses; and (iv) a list of questions to be asked or a request that the questions be asked *viva voce*. There are also specific language requirements, depending on the province to which the letters of request are directed.<sup>6</sup>

Additionally, inquiries may be made, either directly or through local counsel, to DFAIT about any informal practices of the applicable provincial or territorial jurisdiction regarding conventions.

The main difference between letters of request under an evidence convention and letters proceeding under Canada's national statutes (discussed below) is the means by which the letters are transmitted to the appropriate judicial authority for enforcement. The evidence conventions specifically identify diplomatic channels for transmission,<sup>7</sup> and failing to use them could provide a basis for an attack on the letters' validity. While a court will ordinarily permit a technical irregularity to be rectified by reissuance of letters of request, this may delay the enforcement process.

Where the applicable convention procedures are followed, the execution of letters of request can be refused only if the authenticity of the letters is not established or the request is considered to be an infringement of Canadian sovereignty or safety. This latter ground is broad enough to encompass the general tests applied by Canadian courts in determining whether to enforce non-convention letters of request (as described further below). Hence, while the impact of the conventions seem to be primarily procedural, the substantive threshold for enforcement is most likely the same.

## **2. Letters of request in absence of evidence convention**

As noted above, it is relatively uncommon for letters of request to be governed by an evidence convention. Where no convention exists between Canada and the country that makes the request for assistance—the United States and United Kingdom being primary examples—the *Canada Evidence Act*<sup>8</sup> and comparable provincial/territorial legislation provide the jurisdiction for receiving and enforcing foreign requests for assistance.

An application to enforce letters of request can proceed under the *Canada Evidence Act* or any applicable provincial/territorial legislation. In provinces/territories that have enacted legislation, the practice is to apply concurrently in the same court proceeding under both the *Canada Evidence Act* and the relevant provincial/territorial statute.

All provinces and territories except Quebec, New Brunswick, Newfoundland and Prince Edward Island

have enacted legislation similar to the *Canada Evidence Act* provisions relating to foreign requests for assistance.<sup>9</sup> These statutes permit the courts of a province/territory to recognize and enforce requests by a foreign court of competent jurisdiction for the taking of testimony of, or the production of documents by, persons within the jurisdiction of the requested court. Although these statutes may contemplate more than one procedure by which evidence in Canada may be sought, the most common method is by letters of request.

#### **a. Nature of application to enforce request**

Letters of request must be issued by a court within the jurisdiction of the requesting state. An application to enforce the letters of request is then brought in the applicable Canadian provincial/territorial superior court (for example, the Superior Court of Justice in Ontario). In most cases, the application is made on notice to the person or entity specified in the letters and must be supported by an affidavit setting out the facts necessary to satisfy the criteria applied by the court to determine whether to enforce the request (these are reviewed in more detail below).

#### **b. Threshold tests for enforcing letters of request under national statutes**

While the wordings of the *Canada Evidence Act* and the provincial/territorial statutes differ slightly, generally they all confer on the relevant Canadian court a discretion to enforce requests for assistance if the following threshold tests are met: (1) it is made to appear that a foreign court or tribunal of competent jurisdiction desires to obtain evidence in relation to a civil, commercial or criminal matter pending before it; (2) the evidence is for a purpose for which letters of request could be issued under the rules of the Canadian court; and (3) the evidence sought is within the jurisdiction of the Canadian court.<sup>10</sup> Each of these tests have been the subject of judicial interpretation.

##### **(i) Court or tribunal outside Canada**

The *Canada Evidence Act* was amended in 1998 to replace the phrase “court or tribunal of competent jurisdiction” with “court or tribunal outside Canada.” The purpose of the amendment was apparently to ensure that Canadian courts could cooperate with requests for assistance from international tribunals, and that a letter of request from a war crime tribunal, for example, would not be rejected for want of “competent jurisdiction.”<sup>11</sup>

Although the range of courts and tribunals from which letters of request could be received in Canada was expanded by the amendment, the body of case law interpreting the previous language—“court or tribunal of competent jurisdiction”—is still relevant.

The requirement that the requesting body be a “court or tribunal of competent jurisdiction” is satisfied where a Canadian court can look to the requesting tribunal or some other authority within that country for similar assistance.<sup>12</sup> For this reason, letters of request should state that the requesting court is ready and willing to assist Canada in a similar case in the future. Where the necessary reciprocity is lacking, the foundation for the court’s jurisdiction in these matters—international comity—is lacking and the request for assistance could be denied.

Thus, older Ontario case law has held that requests for assistance from foreign administrative tribunals should be denied for, *inter alia*, lacking the ability to reciprocate.<sup>13</sup> Subsequent judgments, however, have cast doubt on this stance; in particular, the Ontario Court of Appeal has since held that “it is inappropriate to limit considerations of reciprocity to the powers of a particular court or tribunal. Rather, the question must be, is there a mechanism in place within the foreign jurisdiction which could respond favourably to a Canadian request by way of letters rogatory?”<sup>14</sup>

In theory, the new focus on the presence of an enforcement mechanism “within the foreign jurisdiction” may provide an avenue through which a Canadian court could enforce a letter of request made directly by a private arbitration panel in another country. However, this interpretation has not yet been tested. Currently, the accepted manner whereby letters of request are enforced for use in a foreign arbitration is for the arbitral panel or parties to the arbitration to obtain a letter of request from the relevant court in its jurisdiction and then seek to have the letter of request enforced in Canada.<sup>15</sup>

##### **(ii) Purpose for which letters of request could be issued in Canada**

The enforcement of letters of request is not limited to situations in which a Canadian court would require evidence if the litigation were being conducted in Canada. Rather, letters are enforceable when they are directed at a *purpose* for which letters of request *could* be issued by the Canadian court.<sup>16</sup> These purposes include, for example, under the Ontario Rules of Civil Procedure, examinations for discovery of, and documentary production by, parties and non-parties (although the latter may require leave of the court), taking evidence from a witness out of court prior to a pending motion or trial, out-of-court cross-examinations on affidavits, and out-of-court examinations in aid of execution of a judgment.

##### **(iii) Evidence sought is within jurisdiction of requested court**

Letters of request must set out the grounds on which it is known or believed that the evidence sought

is within the jurisdiction of the requested court. A Canadian court cannot provide assistance to obtain evidence beyond its jurisdiction.

**c. Discretion to refuse or limit request where threshold is met**

If the threshold tests set out above are satisfied, the Canadian court retains a discretion whether to give effect to the foreign court's request for assistance.<sup>17</sup> The factors governing the exercise of this discretion are set out below.

**(i) Evidence is relevant**

If the evidence sought is not shown to be relevant, the request for assistance may be refused, or "read down" if it is overbroad.<sup>18</sup> It is essential, therefore, that letters of request refer to the facts necessary to establish that the evidence sought is relevant to the proceedings in which it will be used. While Canadian courts may show deference to the foreign court's determination of relevance, they are not "a mere 'rubber-stamp' of an extra-jurisdictional court."<sup>19</sup> Requests amounting to "fishing expeditions" will be refused.<sup>20</sup> Thus, a letter of request issued by a United States court containing a statement that certain documents were relevant "because they might lead to the discovery of admissible evidence" was rejected by an Ontario court. The Ontario court found that documents that are "merely potentially relevant" were not properly the subject of the letter of request since, among other things, such a broad view of relevance was not proper for discovery of a non-party and could be characterized as a fishing expedition.<sup>21</sup>

**(ii) Evidence is necessary for discovery and/or trial**

Although it was previously the case in Canada that letters of request would be enforced only if the evidence was necessary for trial, this is no longer the case.<sup>22</sup> It must now be shown that the evidence sought is necessary for either pretrial discovery or trial,<sup>23</sup> although the admissibility of the evidence remains subject to applicable evidentiary rules in the requesting jurisdiction.<sup>24</sup>

**(iii) Evidence is not otherwise available**

It is important to show that the evidence sought is not available in the requesting jurisdiction; a bare assertion in this regard is not sufficient.<sup>25</sup> For example, where the requesting party failed to establish that the evidence it sought could not be obtained from the opposite party within the jurisdiction, the request to obtain evidence from Canadian parties was refused.<sup>26</sup> The implication of recent Ontario decisions on the point is that while a request for pretrial discovery may be proper, a letter of request issued prior to discovery may not be proper because it is not possible to establish the element of necessity when discovery in the requesting jurisdiction has not yet taken place.<sup>27</sup> In this regard, it

will also be helpful for the requesting party to show that the cooperation of the prospective witness has been requested and refused.

**(iv) Documentary evidence is identified with reasonable specificity**

A general request for documents will not be enforced. Requested documents must be identified as precisely as possible, given the applicant's state of knowledge. At a minimum, documents must be identified by class.<sup>28</sup> Where the scope of the requested documents is too broad, the Canadian court may still give effect to the request after exercising its discretion to "read down," or narrow the scope of the request.

**(v) Order sought is not contrary to public policy or unduly burdensome**

The substance of letters of request is measured against what the witness's obligations would be if the litigation were being conducted in Canada. Subjecting a witness to a procedure provided for by the applicable Canadian court rules to serve the interests of justice in the requesting state—even if onerous—is neither contrary to public policy nor prejudicial to Canadian sovereignty.<sup>29</sup>

It is typical, however, for Canadian courts to invoke this consideration in limiting the scope of the request, either in the breadth of information sought or in the use to which the information so obtained can be put. For example, Ontario courts often require that information and evidence obtained on the basis of a U.S. letter of request be subject to the implied undertaking rule. This rule, not recognized in the United States, operates to protect information obtained through the discovery process from being used in any other proceeding.<sup>30</sup>

Yet not all differences between Canadian procedures and those of the requesting jurisdiction move the courts in the same way. For example, the Ontario Court of Appeal upheld the validity of a U.S. letter of request that sought four witnesses to be examined for discovery, even though Ontario's rules of discovery ordinarily permit only one witness to be examined. The Court found "no valid objection to the requirement that four persons be produced for oral discovery, as that appears consistent with California practice."<sup>31</sup>

**III. Conclusion**

In seeking evidence in Canada for a foreign proceeding, the first step might be to seek the prospective witness's cooperation. A favorable response may avoid the need to involve Canada's courts. An unfavorable response may be considered by a Canadian court hearing an application to compel the evidence in Canada.

The next step would be to determine whether a convention exists between Canada and the requesting

state. If it does, the convention's requirements and any informal practices of the relevant provincial/territorial jurisdiction in dealing with conventions should be identified and followed.

The third step would be to address in conjunction with Canadian legal counsel, before the letters of request are sought, the matters that the Canadian court would consider on an application to enforce the letters. This should not be left to the enforcement stage. Addressing these matters in the letters of request will lay the foundation for a Canadian court to enforce the letters.

## Endnotes

1. *Zingre v. The Queen*, [1981] 2 S.C.R. 392 at 401 ("Zingre"); Freeman and Harney, *Obtaining Evidence from Canada: The Enforcement of Letters Rogatory by Canadian Courts*, 21 U.B.C. L. Rev. 351 at 352-354 (1987).
2. "Blocking statutes" may be an impediment to producing documentary evidence on a voluntary basis. Various federal and provincial statutes—the so-called blocking statutes—prohibit the removal from a province or from Canada of certain types of evidence, including business records. An example of this type of legislation is Ontario's *Business Records Protection Act*, R.S.O. 1990, c. B-19 (the "BRPA"). The objective of blocking statutes is to protect Canadian businesses from foreign judicial interference, such as antitrust prosecutions. The BRPA, for example, prohibits the removal from Ontario of any account, balance sheet, profit and loss statement or inventory or any résumé or digest thereof or any other record, statement, report, or material in any way relating to any business carried on in Ontario, except in certain circumstances defined in the BRPA. Where a witness is willing to produce documents voluntarily, in the absence of a court order, a query should be made whether the requesting state and the witness are in violation of this prohibition.
3. Department of External Affairs, *International Judicial Cooperation* at 10-11 (Ottawa: 1987).
4. *Id.* at 34-35. Examples of potentially applicable privacy and access to information legislation include the *Access to Information Act*, R.S.C. 1985, c. A-1, the *Freedom of Information and Privacy Act*, R.S.O. 1990, c. F31, and the *Personal Information Protection and Electronic Documents Act*, S.C. 2000, c. 5.
5. See, for example, *Richter Gedeon Vegyeszeti Gyar Rt v. Merck & Co.*, [1995] 3 F.C. 330 at 347, 350-51 (C.A.), discussing the convention between Canada and Hungary.
6. Letters of request must also be in, or be accompanied by a translation into, English when directed to any province other than Manitoba, New Brunswick, Ontario or Quebec. Letters of request directed to the latter provinces may be in either English or French.
7. Where a convention applies, letters of request issued by a foreign court are typically sent to the foreign country's embassy in Canada, and from there transmitted to DFAIT under cover of a diplomatic note. DFAIT forwards the letters to the appropriate provincial/territorial department of justice for enforcement by the department or by local counsel.
8. R.S.C. 1985, c. C-5, s. 46.
9. *Alberta Evidence Act*, R.S.A. 1980, c. A-21, s. 57; *British Columbia Evidence Act*, R.S.B.C. 1996, c. 124, s. 53; *Manitoba Evidence Act*, R.S.M. 1987, c. E-150, s. 82; *Northwest Territories and Nunavut Evidence Act*, R.S.N.W.T. 1988, c. E-8, s. 72; *Nova Scotia Evidence Act*, R.S.N.S. 1989, c. 154, s. 70; *Saskatchewan Evidence Act*, R.S.S. 1978, c. S-16, s. 53; *Yukon Evidence Act*, R.S.Y. 1986, c. 57, s. 63. The applicable Act should be reviewed to determine if there are any relevant differences, given the context of the evidentiary request. The *Canada Evidence Act*, for example, permits evidence to be taken by videoconference, while many provincial statutes do not: see *Canada Evidence Act*, s. 46(2).
10. *Republic of France v. De Havilland Aircraft of Canada Limited* (1991), 3 O.R. (3d) 705 at 710 (C.A.) ("Republic of France").
11. See statement of the Hon. Lloyd Axworthy before the Parliamentary Standing Committee on Justice and Human Rights, 5 November 1998: "[E]nacting this legislation for co-operation with international tribunals is a priority."
12. *Republic of France*, note 10 *supra*, O.R. (3d) at 713.
13. *McCarthy v. Menin*, [1963] 2 O.R. 154 (C.A.).
14. *Republic of France*, note 10 *supra*, 3 O.R. (3d) at 714.
15. *Re Corporation Transnacional de Inversiones, S.A. de C.V. v. STET International, S.p.A.* (1999), 45 O.R. (3d) 183 (Ont. S.C.J.), *aff'd* (2000), 49 O.R. (3d) 414 (Ont. C.A.); *Four Seasons Hotel Ltd. v. Legacy Hotels Real Estate Investment Trust*, [2003] O.J. No. 1341 (S.C.J.) ("Four Seasons Hotel").
16. *Re Mulronev v. Coates* (1986), 27 D.L.R. (4th) 118 at 128 (Ont. H.C.J.).
17. *Re Friction Division Products, Inc. and E.I. DuPont de Nemours & Co. Inc.* (No. 2) (1986), 56 O.R. (2d) 722 at 732 (H.C.J.).
18. *W.R. Grace Co. v. Brookfield Development Corp.* (1995), 41 C.P.C. (3d) 130 at 131 (Ont. Gen. Div.) ("W.R. Grace Co."); *General Conference of Seventh Day Adventists v. Tiffin*, [2000] O.J. No. 3506 (S.C.J.), *aff'd* [2001] O.J. No. 885 (C.A.), *leave to appeal to S.C.C. dismissed* 27 September 2001.
19. *W.R. Grace Co.*, note 18 *supra*.
20. *Zingre*, note 1 *supra*, (1981) 2 S.C.R. at 401.
21. *Taft v. Siemens Electric Ltd.*, [2000] O.J. No. 103 at ¶12-¶16 (S.C.J.).
22. *Zingre*, note 1 *supra*, (1981) 2 S.C.R. at 403-404; *Fecht v. Deloitte & Touche* (1996), 28 O.R. (3d) 188 (Gen. Div.), *aff'd* (1997) 32 O.R. (3d) 417 (C.A.) ("Fecht").
23. This includes examinations in aid of execution to enforce a judgment: *Four Embarcadero Center Venture Ltd. v. Mr. Greenjeans Corp.* (1987), 59 O.R. (2d) 229, *aff'd* (1988), 65 O.R. (2d) 256 (C.A.).
24. *Fecht*, note 22 *supra*; *Tiffin*, note 18 *supra*, [2000] O.J. No. 3506 at ¶11 (S.C.J.).
25. *Re Friction Division Products*, note 17 *supra*, (1986), 56 O.R. (2d) at 732.
26. *Internet Law Library Inc. v. Matthews*, [2003] O.J. No. 1139 (S.C.J.).
27. *Id.*
28. *Re Friction Division Products*, note 17 *supra*, (1986), 56 O.R. (2d) at 734-737.
29. *Henry Bacon Building Materials Inc. v. Royal Canadian Mounted Police* (1994), 98 B.C.L.R. (2d) 59 at 70 (S.C.).
30. *Pecarsky v. Lipton Wiseman Altbaum & Partners* (1999), 38 C.P.C. (4th) 170 (Ont. S.C.J.); *Four Seasons Hotel*, note 15 *supra*.
31. *OptiMight Communications, Inc. v. Innovance Inc.*, [2002] O.J. No. 577 (C.A.) at ¶33.

**Cynthia Tape is a litigation and intellectual property lawyer with Torys LLP, a U.S.-Canadian business law firm with offices in Toronto and New York City. Peter Balasubramanian, formerly a litigation lawyer with Torys LLP, is corporate counsel with the Ontario New Home Warranty Program in Toronto.**



# Corporate Liability Under the Alien Tort Claims Act: United States Court Jurisdiction over International Torts

By Richard T. Marooney

## I. Introduction

Ecuadorian and Peruvian residents claim that an Ecuadorian oil consortium polluted the rainforest in Ecuador and Peru and injured thousands of residents of those countries. Non-Muslim residents of Sudan claim they were victims of heinous human rights violations committed in connection with oil exploration and development activities in Sudan. Nigerian citizens allege they were tortured by Nigeria's military working together with oil companies conducting oil exploration and development activities in Nigeria. Croat and Muslim citizens of Bosnia-Herzegovina allege they were victims of rape, forced prostitution, torture and other human rights violations committed by Bosnian-Serb military forces. Citizens of Zimbabwe claim Zimbabwe residents acting under color of state law committed acts of torture and violence against other Zimbabwe citizens to suppress their political views. The list goes on.

What do these claims have in common? Notwithstanding they have little, if anything, to do with the United States, all were actual lawsuits filed in U.S. courts by U.S. plaintiffs' lawyers under a U.S. statute enacted in 1789—the Alien Tort Claims Act, 28 U.S.C. § 1350 (“ATCA”), as amended in 1991 by the Torture Victim Protection Act (“TVPA”). The 1990s marked the beginning of a new wave of litigation under the ATCA against U.S. companies. Investment in overseas business ventures can now result in protracted U.S. litigation under the ATCA, and energy companies top the list of favored targets. These cases have provided opportunities for eye-catching media releases accusing companies of international human rights violations, “cultural genocide,” “environmental hooliganism,” ignoring the “rights of the family,” and the like.

Why this recent explosion of litigation under a statute that has been on the books for over two hundred years and has essentially remained dormant until the last decade? The perceived reasons for this outburst of litigation range as broadly as the sympathies of the person asked. Some have said the cases reflect an effort by zealous plaintiffs' lawyers to federalize claims having little to no connection with U.S. residents, commerce, or interests in order to take advantage of accommodating procedural rules in U.S. courts, including class action procedures, and the well-known propensity of U.S. juries to award huge damage awards, including punitive damages. Having utilized the ATCA as the basis for federal court jurisdiction, plaintiffs' counsel then add pendent state law claims as additional

grounds for damages. What is beyond dispute, in any event, is that ATCA claims are now a fact of life for U.S. companies engaged in international business, particularly energy companies. It thus behooves those companies and their counsel to understand this trend and how U.S. courts view these cases.

This article, therefore, provides an overview of the ATCA and some defenses available to corporations named as defendants in ATCA lawsuits. It addresses the origin and purpose of the ATCA, the substantive elements of a viable ATCA claim, the case law under the ATCA relating to U.S. and foreign corporations, and the types of defenses advanced to date by corporate defendants in ATCA lawsuits. This article is not intended to cover all aspects of the ATCA's origin, purpose or reach, but rather to identify key points for practitioners working with companies engaged in international activities.

## II. The Alien Tort Claims Act

### A. Origin and Purpose of the ATCA

In 1789, the first Judiciary Act created the U.S. Supreme Court and federal courts and articulated the matters over which such courts could assert jurisdiction. The Act granted federal courts original jurisdiction over all suits exceeding \$500 where the United States is the plaintiff, or an alien is a party, or the suit is between citizens of different states.<sup>1</sup> It also contained the ATCA, which granted federal courts original jurisdiction “of all causes where an alien sues for a tort only in violation of the law of nations or a treaty of the United States.”<sup>2</sup>

Congress has amended the wording of the ATCA three times over the intervening two hundred twelve years. It now reads: “The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.”<sup>3</sup>

The original purpose of the ATCA is uncertain—“a matter that is forever hidden from our view by the scarcity of relevant evidence.”<sup>4</sup> Nonetheless, courts and jurists have suggested that the ATCA had a narrower purpose than serving as a vehicle through which to file international human rights cases. In an opinion described by the Second Circuit Court of Appeals as “[t]he most learned exposition” on the ATCA's original purpose, Judge Harry T. Edwards explained that Congress probably enacted the ATCA in 1789 to ensure that U.S. courts (as opposed to state courts) would have

jurisdiction over claims by aliens to prevent state courts from mishandling matters with international implications.<sup>5</sup> Others have suggested that the ATCA was enacted for the sole purpose of addressing wrongs committed by crews of vessels in the course of stopping and boarding ships suspected of aiding the enemy in a time of war.<sup>6</sup> As with many statutes, however, the statutory language can be read more broadly than its authors may have intended, and some lawyers and courts have chosen to adopt an expansive interpretation, as discussed below.

## B. The *Filartiga* Decision

The case that marked the beginning of the current wave of ATCA litigation was the 1980 decision by the Second Circuit Court of Appeals in *Filartiga v. Pena-Irala*. Prior to 1980, courts had sustained jurisdiction under the ATCA only twice during its then 191-year history: once in a 1795 maritime seizure case,<sup>7</sup> and once in a 1961 child custody case.<sup>8</sup> *Filartiga*, however, heralded a new day in ATCA litigation.

In *Filartiga*, a Paraguayan physician filed a lawsuit in a New York federal district court against a former government official of Paraguay, alleging that the official and others had tortured and killed the physician's son in Paraguay because of the physician's political beliefs. Plaintiff argued that the court had jurisdiction over the case under the ATCA because the government official had allegedly committed a tort (torture) in violation of the "law of nations." The district court disagreed and dismissed the case for lack of jurisdiction, but the Second Circuit Court of Appeals reversed. It held that the district court had jurisdiction under the ATCA because (1) plaintiff was an "alien" who (2) had alleged that defendant had committed a tort (torture), (3) in violation of the "law of nations" as set forth in the ATCA.<sup>9</sup>

Significantly, the *Filartiga* decision also made clear that while the ATCA expresses itself in the form of a grant of subject matter jurisdiction to federal courts over claims by aliens for a violation of the law of nations, it also provides plaintiffs a substantive cause of action for damages.<sup>10</sup> Subsequent cases have followed *Filartiga's* lead in holding that the ATCA provides both a basis for federal court jurisdiction and a private right of action for damages.<sup>11</sup>

## C. Elements of an ATCA Claim

To assert a claim under the ATCA, a plaintiff must meet three requirements under the plain language of the statute: (1) plaintiff must be an "alien"; (2) plaintiff must allege that defendant committed a "tort"; and (3) the alleged "tort" must violate either a treaty or "the law of nations."<sup>12</sup> Because plaintiffs rarely allege that a private corporation violated a treaty, the case law has focused on the "law of nations" element rather than on

treaty violations in cases involving corporate defendants. Thus, this article addresses only the "law of nations" aspect of the ATCA.

A threshold question in any ATCA case against a private company, therefore, is whether a foreign plaintiff has alleged a violation of "the law of nations," or international law in modern-day parlance. In addition, a plaintiff generally must allege not only that a defendant violated the law of nations but also did so as a "state actor" or under color of state law, although certain exceptions exist to this state action requirement.<sup>13</sup> The definition of "the law of nations" and the color of state law requirements are discussed below.

### 1. A Violation of the Law of Nations

What constitutes a violation of the "law of nations" has been the subject of much discussion among courts and jurists. Courts to date have taken a restrictive view, recognizing only few offenses that violate "the law of nations" and thus can form the basis of an ATCA claim. Creative plaintiffs' attorneys are now pleading their allegations accordingly in hopes of surviving a motion to dismiss.

For an offense to violate the "law of nations" under the ATCA, the alleged offense must be "definable, obligatory (rather than hortatory), and universally condemned."<sup>14</sup> The reason is to prevent "the courts of one nation [from imposing] idiosyncratic legal rules upon others in the name of applying international law."<sup>15</sup> Thus, the alleged conduct must violate "well-established, universally recognized norms of international law."<sup>16</sup> As one court has held, the ATCA "applies only to shockingly egregious violations of universally recognized principles of international law."<sup>17</sup>

To determine what constitutes "international law," courts "interpret international law not as it was in 1789, but as it has evolved and exists among the nations of the world today."<sup>18</sup> The law of nations "may be ascertained by consulting the works of jurists, writing professedly on public law; or by the general usage and practice of nations; or by judicial decisions recognizing and enforcing that law."<sup>19</sup> The "law of nations," in other words, is an evolving, dynamic concept rather than a static one. Offenses recognized as violating the law of nations include to date: genocide; torture; slavery or slave trading; forced labor; piracy; war crimes; and other egregious human rights violations. If a plaintiff fails to allege that defendant committed or actively participated in one of these offenses, then a federal court should dismiss the claim. *See* Part V.B *infra*.

### 2. The State Action Requirement

Generally, a plaintiff who sues a corporation under the ATCA also must allege that the corporation was a "state actor." This means that the plaintiff must estab-

lish a legally sufficient connection between the corporation and governmental activity related to the alleged acts that form the basis of the ATCA claim. The Second Circuit has stated that “[t]he ‘color of law’ jurisprudence of 42 U.S.C. § 1983 is a relevant guide to whether a defendant has engaged in official action for purposes of jurisdiction under the Alien Tort Act”; the objective is to determine whether the corporation “act[ed] together with state officials or with significant state aid” in the course of carrying out the allegedly bad acts.<sup>20</sup> See Part V.C. *infra*.

Courts have held, however, that some particularly egregious offenses do not require a plaintiff to allege that the corporation was a “state actor.” These offenses include genocide and war crimes, and may also include others such as slave trading, attacks on or hijacking of aircraft, piracy, and certain acts of terrorism. If a plaintiff alleges that a corporation has committed one of these offenses, then the plaintiff need not prove that the corporation was a “state actor.”<sup>21</sup> Nonetheless, plaintiff still must plead and prove defendant’s participation in these offenses to establish liability under the ATCA. See Part V.C. *infra*.

### III. The Torture Victim Protection Act

In 1991, Congress amended the ATCA by passing the TVPA to address torture claims. The TVPA codified the Second Circuit’s decision in *Filartiga* by recognizing that U.S. courts have jurisdiction over suits by aliens alleging torture or “extrajudicial killing” committed under “actual or apparent authority, or color of law, of any foreign nation.” In addition, the TVPA applies to any “individual” (including non-aliens) and expressly grants a substantive right to damages in U.S. courts if that individual was a victim of torture or extrajudicial killing.<sup>22</sup> Thus, unlike the ATCA, which applies only to aliens and expresses itself only in terms of a grant of jurisdiction to federal courts, the language of the TVPA provides an express cause of action for all individuals, regardless of nationality, seeking damages for victims of torture and extrajudicial killings.

### IV. Examples of ATCA Cases against U.S. and Foreign Companies

Energy companies, including ChevronTexaco, Unocal, Shell Oil, and Exxon Mobil, have been named as defendants in ATCA suits, but they are not alone. Other categories of companies also have been sued under the ATCA, including beverage companies, automotive companies, clothing retailers, mining companies, drug manufacturers, and financial institutions. Set forth below is a bullet-point sample list of some of the more publicized ATCA cases to date against U.S. and foreign companies. This list is illustrative and is by no means exhaustive:

- *Aguinda v. Texaco Inc.*, 142 F. Supp. 2d 534 (S.D.N.Y. 2001), *aff’d*, 303 F.3d 470 (2d Cir. 2002) (affirming dismissal of ATCA action on *forum non conveniens* grounds brought by thousands of residents of Ecuador and Peru arising from oil exploration and development activities in Ecuador).
- *Doe v. Unocal Corp.*, \_\_\_ F.3d \_\_\_, 2003 WL 359787 (9th Cir. 14 Feb. 2003) (ordering rehearing en banc of 18 September 2002 opinion holding that the correct test for determining liability should be whether Unocal gave “knowing practical assistance or encouragement that has a substantial effect on the perpetration of the crime;” en banc decision not rendered as of the date this article was submitted for publication).
- *Bowoto v. Chevron Corp.*, No. C99-2506 (N.D. Cal. filed 27 May 1999) (Nigerian residents alleging Chevron, acting in concert with Nigeria’s military and police, violated plaintiffs’ human rights; case is pending).
- *Beanal v. Freeport McMoran, Inc.*, 197 F.3d 161 (5th Cir. 1999) (affirming dismissal of Indonesian plaintiff’s ATCA claim for alleged “cultural genocide” and environmental torts in connection with Freeport’s operation of a copper, gold and silver mine in Indonesia).
- *Sinaltrainal v. Coca-Cola Co.*, 256 F. Supp. 2d 1345 (S.D. Fla. 2003) (dismissing ATCA claim by Columbian trade union alleging that defendants had murdered and tortured Columbian workers to encourage them to terminate their involvement with organized labor unions; holding plaintiffs could not allege that the company controlled or participated in the alleged wrongful conduct).
- *Flores v. S. Peru Copper Corp.*, 343 F.3d 140 (2d Cir. 2003) (affirming dismissal of ATCA claim brought by Peruvian plaintiffs arising from defendant’s copper mining and refining operations, holding that ATCA claim based on “right to life” and “right to health,” as well as claims based on environmental wrongs not sufficiently definite to give rise to a cause of action).
- *Abdullahi v. Pfizer, Inc.*, No. 01 Civ. 8118, 2002 WL 31082956 (S.D.N.Y. 17 Sept. 2002) (dismissing on *forum non conveniens* grounds ATCA claim brought by Nigerian residents alleging grave injuries from experimental antibiotic administered by Pfizer without their informed consent), *vacated and remanded*, 77 Fed. Appx. 48 (remanding to determine if dismissal of parallel action in Nigeria precluded dismissal of aliens’ action on ground of *forum non conveniens*).

- *Wiwa v. Royal Dutch Petroleum Co.*, No. 96 Civ. 8386, 2002 WL 319887 (S.D.N.Y. 28 Feb. 2002) (denying motion to dismiss ATCA claim brought by Nigerian émigrés arising from oil exploration activities in Nigeria).
- *Presbyterian Church of Sudan v. Talisman Energy, Inc.*, 244 F. Supp. 2d 289 (S.D.N.Y. 2003) (denying motion to dismiss ATCA claim brought by non-Muslim residents of Sudan arising from oil exploration activities in Sudan; plaintiffs alleged Talisman acted in concert with government of Sudan in committing genocide, murder, torture and other human rights violations).

## V. Defenses to ATCA Claims

A corporate defendant should consider at the outset of an ATCA case whether to assert the defenses discussed briefly below. Courts address most of these defenses at the initial stage of the case, and the personal jurisdiction defense may be waived if a defendant does not raise it upon filing its initial motion to dismiss. Some defenses, however, may require some discovery to develop a factual record to support a motion to dismiss (e.g., *forum non conveniens* and whether defendant was a “state actor” or otherwise participated in the alleged wrongdoing). The likelihood of success of these defenses can be highly fact-specific.

### A. *Forum Non Conveniens*

While a federal court may have subject matter jurisdiction, it is not required to exercise that jurisdiction in all cases. Various discretionary doctrines give a federal court flexibility under some circumstances to decline jurisdiction in favor of another forum. The doctrine of *forum non conveniens* is one such doctrine. It allows federal courts to dismiss cases to another nation’s court system if litigation there would better serve the convenience of the parties and interests of justice. This discretionary doctrine assumes that U.S. courts have jurisdiction over the particular case, but allows courts to dismiss the case if (i) an available and adequate alternative forum exists to hear the dispute, and (ii) the public and private interest factors articulated by the U.S. Supreme Court in *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501 (1947), weigh in favor of dismissal.

The *forum non conveniens* argument, however, can sometimes be difficult for corporate defendants in ATCA cases. The proposed alternative forum is often the plaintiffs’ home country where the alleged activities occurred and where most evidence is located. If plaintiffs allege that the government in their country committed egregious human rights violations against them and that they would be subject to further abuse if trial were to proceed in their country, U.S. courts are often reluctant to rule that the alternative forum is adequate.<sup>23</sup> If a defendant proposes a forum other than the

country in which the acts took place, it faces the challenge of showing why the proposed country is more convenient than the United States to hear the dispute.<sup>24</sup>

In addition, federal courts require a defendant to agree to certain conditions prior to dismissing the case, including consenting to jurisdiction in the foreign country for purposes of the litigation. This may compel the corporation to expose itself to liability in a foreign country in which it otherwise could not be sued on personal jurisdiction grounds. While an operating subsidiary may already be subject to jurisdiction in the country in which it conducted business, its U.S. parent company, which is often the named defendant or at least a co-defendant, might not be subject to jurisdiction there, absent its consent, because it conducted no business activities in the country and had no contacts other than its investment in its subsidiary. Courts have held, however, that the parent company must subject itself to jurisdiction in the foreign forum prior to dismissing on *forum non conveniens* grounds, and have rejected the argument that the subsidiary’s presence in the foreign forum satisfies the named defendant’s obligation to be amenable to process in the alternative forum.<sup>25</sup> Thus, a corporate defendant must weigh the risks and benefits of voluntarily submitting itself to jurisdiction in a foreign country prior to moving to dismiss on *forum non conveniens* grounds.

### B. No Violation of the Law of Nations

As noted previously, a plaintiff must allege that a defendant violated the “law of nations” in order to state an ATCA claim. See Part II.C.1 *supra*. Failure to do so should result in the dismissal of the claim. To avoid becoming international policemen as to all perceived injustices in foreign venues, federal courts take an appropriately stringent view as to what constitutes a violation of the “law of nations,” and only certain egregious human rights violations qualify. Thus, a corporate defendant should review the allegations of the complaint carefully at the outset of the case to determine whether plaintiff has alleged a violation of “the law of nations.” A court need not assume the existence of a valid ATCA claim simply because plaintiffs have pleaded what they believe or hope to be an ATCA claim.<sup>26</sup>

For example, courts to date have rejected the argument that alleged “environmental wrongs” can form the basis of an ATCA claim.<sup>27</sup> The reason is that no consensus exists among developed and underdeveloped nations regarding environmental practices. What some nations prohibit, others encourage, and environmental priorities vary widely. As the Fifth Circuit warned in holding that plaintiffs’ environmental allegation did not state an ATCA claim, “federal courts should exercise extreme caution when adjudicating environmental claims under international law to insure that environ-

mental policies of the United States do not displace environmental policies of other governments.”<sup>28</sup>

Courts also have dismissed ATCA claims for failure to allege a violation of the law of nations based on price-fixing activities<sup>29</sup> and the acquisition of real property appropriated by a foreign government on the basis of plaintiff’s religious beliefs.<sup>30</sup> These holdings emphasize that ATCA cases should be limited to egregious human rights violations universally condemned by the international community. Failure to do so would have the undesirable result of throwing open the door to litigation in U.S. courts of all manner of alleged tortious activity having little to no connection with the United States.

### C. No State Action or Participation in the Alleged Wrongdoing

As noted above, with few exceptions, a plaintiff also must show that the corporate defendant that allegedly violated the “law of nations” did so as a “state actor.” The U.S. Supreme Court has taken a flexible approach in determining what constitutes “state action,” applying four distinct tests to the facts of each case: public function; state compulsion; nexus; and joint action. The case law is still developing concerning the nature and extent of the required participation by a private party sufficient to satisfy the state action requirement or to form the basis of a valid ATCA claim for violations of international law that do not require state action. What is clear, however, is that some form of participation in the wrongdoing is required. The Court in *Beanal v. Freeport-McMoran*, for example, held that the joint action test requires “some actual participation or cooperation” by both the government and defendant corporation, and plaintiff’s complaint failed to adequately plead such facts.<sup>31</sup> Further, the court also held under the “nexus” test that “a government contract conferring a mining concession and government investment in the operation are insufficient facts, standing alone” to satisfy the ATCA’s “state action” requirement.<sup>32</sup> In the Ninth Circuit’s *John Doe I v. Unocal Corporation* decision that it later vacated to rehear en banc, the Ninth Circuit held that the private entity must provide “knowing practical assistance or encouragement that has a substantial effect on the perpetration of the crime.”<sup>33</sup>

While the case law regarding state action and the degree of knowing participation by private parties is not well-developed, the lesson from the decisions to date is that courts will require more than mere knowledge of alleged human rights abuses for a cause of action to arise. Instead, plaintiffs must allege and demonstrate that the corporation participated in the alleged human rights violations. In addition, the mere fact that the corporation entered into a concession agreement with a foreign government is insufficient to

establish that the corporation was a “state actor” for ATCA purposes.

### D. No Personal Jurisdiction

While the court may have subject matter jurisdiction over the case under the ATCA, the court may lack personal jurisdiction over the defendant if the corporation lacks sufficient contacts with the court in which the case was filed. This defense applies primarily to foreign corporations. Defendants raised this defense unsuccessfully in the *Wiwa* case. There, the court held that it had personal jurisdiction over defendants who were based in Great Britain and the Netherlands. Even though the *Wiwa* defendants lacked extensive contacts in New York, they maintained an investor relations office there that was deemed sufficient to allow the court to exercise personal jurisdiction over defendants.<sup>34</sup>

### E. International Comity

Principles of international comity, which permit and encourage federal courts to defer to the predominant interests of foreign nations and their tribunals, are deeply rooted in our jurisprudence.<sup>35</sup> The doctrine urges judicial restraint by U.S. courts over cases having strong foreign elements, just as the United States would expect a foreign court to do in the reverse situation.<sup>36</sup> The defense is particularly appropriate where plaintiffs challenge practices and policies of foreign governments not condemned by international law—e.g., a decision to open lands for oil exploration and development activities that may result in the displacement of persons living in the affected region, or a decision to favor economic development over environmental priorities when engaging in exploration and development activities. In such a case, plaintiffs’ claims directly challenge legitimate policies of a foreign government and require a U.S. court to sit in judgment of these policies, thus raising significant international comity concerns.<sup>37</sup>

As in *forum non conveniens* dismissals, a court may require a defendant to consent to dismissal conditions, such as consent to jurisdiction in the foreign tribunal, prior to dismissing on comity grounds.<sup>38</sup> Thus, the corporation will need to weigh the risks and benefits of subjecting itself to foreign jurisdiction prior to moving to dismiss on comity grounds, just as it would prior to moving to dismiss on *forum non conveniens* grounds.

### F. Failure to Join Indispensable Parties

Rule 19 of the Federal Rules of Civil Procedure permits federal courts to dismiss an action when all necessary parties to the litigation cannot be joined in the action. Because ATCA claims against companies often involve a consortium of players (e.g., other companies and a foreign government) and extraterritorial relief, these points raise the possibility for a Rule 19(b) dismissal if all necessary parties cannot be joined in the

U.S. litigation or a federal court is unable to grant complete relief.

The first step in determining whether a Rule 19 dismissal is warranted is determining whether missing parties are “necessary” to the action. A missing party is “necessary” if (i) in the person’s absence complete relief cannot be accorded among those already parties, or (ii) the person claims an interest relating to the subject matter of the action.<sup>39</sup> If the court concludes that a party is “necessary,” then the court must determine “whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed.”<sup>40</sup>

Courts generally have been unreceptive to the indispensable party defense, reasoning that plaintiffs can receive sufficiently complete relief from the named defendant in the form of a money damages award, and that the joinder of others who may be joint tortfeasors is unnecessary to resolve the dispute.<sup>41</sup> Nonetheless, the defense may be invoked to dismiss certain claims for equitable relief requiring the participation of missing parties (e.g., remediation of lands or the implementation of changes in production and development activities controlled by other parties).<sup>42</sup>

In addition, the inability to join other parties to the lawsuit or to obtain discovery from missing parties favors dismissal under the *forum non conveniens* doctrine.<sup>43</sup> Thus, the indispensable party issue may be helpful in supporting a motion to dismiss based on *forum non conveniens* grounds.

### G. The Act of State Doctrine

The “act of state” doctrine gives federal courts the discretion to dismiss a case when it would require the court to sit in judgment on the public acts of a recognized foreign sovereign committed within its own territory.<sup>44</sup> There are no set criteria for determining when the doctrine should apply. Instead, courts weigh the foreign policy interests on a case-by-case basis to determine if the act should apply, taking into account “the likely impact on international relations that would result from judicial consideration of the foreign sovereign’s act,”<sup>45</sup> and considerations of separation of powers in dealing with foreign sovereigns.<sup>46</sup> Courts also have held that the doctrine should not be applied if the policies underlying the doctrine do not justify its application.<sup>47</sup>

As with the defense of international comity, it usually is difficult to establish an act of state defense in the context of an ATCA claim. This is because the alleged offenses that form the basis of an appropriate ATCA claim are, by definition, universally condemned by the international community and, therefore, courts do not consider the offenses alleged by plaintiffs to be legitimate “acts of state.”<sup>48</sup> In addition, the policies underly-

ing the doctrine (e.g., separation of powers and deference to foreign sovereigns) are usually not applicable in ATCA cases involving egregious human rights violations such as torture and murder.<sup>49</sup>

### H. Political Question Doctrine

The origin of the political question doctrine traces back to early federal jurisprudence.<sup>50</sup> In essence, the doctrine calls for federal courts to refrain from deciding certain cases or issues because they are more properly resolved by the executive or legislative branches of government under separation of powers principles. The U.S. Supreme Court in *Baker v. Carr* has articulated six factors that federal courts must consider when deciding if a case presents a political question.<sup>51</sup> If any one of these six factors “is inextricable from the case at bar,” then “dismissal for non-justiciability on the ground of a political question’s presence” is appropriate.<sup>52</sup> Justice Powell has summarized the *Baker* factors as follows: “(i) does the issue involve resolution of questions committed by the text of the Constitution to a coordinate branch of Government? (ii) would resolution of the question demand that a court move beyond areas of judicial expertise? (iii) do prudential considerations counsel against judicial intervention?”<sup>53</sup> ATCA allegations often implicate U.S. foreign policy or foreign relations, and courts have dismissed ATCA claims based on the political question doctrine.<sup>54</sup>

### I. Statute of Limitations

The ATCA does not contain a statute of limitations. The TVPA amendment, however, provides for a ten-year statute of limitations.<sup>55</sup> Courts have applied the TVPA’s ten-year statute of limitations to ATCA cases, reasoning that the TVPA is the most closely analogous federal or state cause of action to the ATCA and, therefore, its statute of limitations is applicable.<sup>56</sup> In addition, courts have held that the statute of limitations does not begin to run if the alleged offense is continuing. It begins to run, instead, from the date of the last wrongful act.<sup>57</sup>

While a statute of limitations defense often is not viable in light of the ten-year statute of limitations and the fact that it does not begin to run until the date of the last wrongful act, defendant should review the allegations of the complaint carefully to determine if a statute of limitations defense may apply. It should also bear in mind that a shorter statute of limitations is likely to apply to any state law causes of action asserted along with the ATCA claim.

## VI. The Significance of Public Relations in ATCA Cases

U.S. plaintiffs’ lawyers typically file ATCA cases in conjunction with well-planned public relations attacks. These attacks are used to support a strategy of trying to

coerce a quick settlement without addressing the merits of plaintiffs' allegations. The lawyers usually hold a press conference when filing the lawsuit, often on the courthouse steps. They receive assistance from non-governmental organizations, which file amicus briefs and post documents on their websites to support plaintiffs' cases. Plaintiffs' lawyers enlist the assistance of the news media to print articles and create television pieces to support their claims. They run television and radio advertisements; they open websites; they organize protests outside of company headquarters; they appear at shareholder meetings; and they fill the courtroom with supporters of their cause. The media often have a regrettable tendency to present allegations as facts, and the ensuing public relations pressures can be real.

Corporate defendants should expect and prepare for the inevitable public relations attack, bearing in mind that such attacks are usually designed to coerce settlement and avoid litigating the case on the merits. To this end, it is important that the corporation develop a well-planned public relations strategy to offset plaintiffs' public relations attack and understand at the outset the public relations issues at stake. It is also important for a defendant's lawyers and public relations team to maintain an open line of communication to coordinate litigation and public relations strategy.

## VII. Conclusion

The past decade has seen an increasing number of ATCA cases asserted against U.S. and foreign companies, and the trend will continue. U.S. federal courts have begun to assert jurisdiction over these cases even though they have little or no connection to the United States. U.S. energy companies now face the risk of protracted U.S. litigation, accompanied by well-planned public relations assaults, simply as a result of overseas investment in exploration and development activities. While U.S. courts generally have been receptive to exercising jurisdiction over ATCA claims, they have imposed important limits on the ATCA that corporations should explore at the outset of any case.

## Endnotes

1. The First Judiciary Act granted to federal courts "original cognizance, concurrent with the courts of the several States, of all suits of a civil nature at common law or in equity, where the matter in dispute exceeds, exclusive of costs, the sum or value of five hundred dollars, and the United States are plaintiffs, or petitioners; or an alien is a party, or the suit is between a citizen of the State where the suit is brought, and a citizen of another State." *Tel-Oren v. Libyan Arab Republic*, 726 F.2d 774, 782 (D.C. Cir. 1984) (Edwards, J., concurring) (citing Judiciary Act of 1789, ch. 20 § 11, 1 Stat. 73, 78 (1789)).
2. Judiciary Act of 1789, ch. 20 § 9(b), 1 Stat. 73, 77 (1789), codified at 28 U.S.C. § 1350.
3. Sweeney, *A Tort Only in Violation of the Law of Nations*, 18 *Hastings Int'l & Comp. L. Rev.* 445, 449 (1995) (hereinafter "Sweeney"). See also 28 U.S.C. § 1350.

4. *Wiwa v. Royal Dutch Petroleum Co.*, 226 F.3d 88, 105 n.10 (2d Cir. 2000), *cert. denied*, 532 U.S. 941 (2001).
5. *Id.* at 105 n.10, citing *Tel-Oren*, note 1 *supra*, 726 F.2d at 782–83 (Edwards, J., concurring): "[T]he intent of [the ATCA] was to assure aliens access to federal courts to vindicate any incident which, if mishandled by a state court, might blossom into an international crisis.").
6. See Sweeney, note 3 *supra*, at 445.
7. *Bolchos v. Darrell*, Bee 74, 3 F. Cas. 810 (No. 1607) (D.S.C. 1795).
8. *Abdul-Rahman Omar Adra v. Clift*, 195 F. Supp. 857 (D. Md. 1961).
9. *Filartiga v. Pena-Irala*, 630 F.2d 876, 884 (2d Cir. 1980).
10. *Id.* at 889.
11. See, e.g., *Abebe-Jira v. Negewo*, 72 F.3d 844 (11th Cir. 1996); *Kadic v. Karadzic*, 70 F.3d 232, 238 (2d Cir. 1995); *In re Estate of Ferdinand Marcos Human Rights Litig.*, 25 F.3d 1467, 1473–75 (9th Cir. 1994); *Iwanowa v. Ford Motor Co.*, 67 F. Supp. 2d 424, 441–42 (D.N.J. 1999); but see *Al Odah v. United States*, 321 F.3d 1134, 1146–49 (D.D.C. 2003) (Randolph, J., concurring) (noting the existence of "a number of problems" with *Filartiga's* holding that the ATCA creates a private right of action for damages), *cert. granted*, 124 S. Ct. 534 (10 Nov. 2003); *Tel-Oren*, note 1 *supra*, 726 F.2d at 788 (Bork, J., concurring) (reasoning the ATCA is purely a jurisdictional statute, and a plaintiff must find an explicit grant of a private right to sue under the law of nations).
12. *Kadic*, note 11 *supra*, 70 F.3d at 238.
13. *Id.* at 239–44.
14. *Filartiga*, note 9 *supra*, 630 F.2d at 881.
15. *Id.*
16. *Kadic*, note 11 *supra*, 70 F.3d at 239.
17. *Zapata v. Quinn*, 707 F.2d 691, 692 (2d Cir. 1983) (per curiam).
18. *Filartiga*, note 9 *supra*, 630 F.2d at 881.
19. *Id.* at 880.
20. *Kadic*, note 11 *supra*, 70 F.3d at 245.
21. *Id.* at 241.
22. The TVPA provides that "an individual who, under actual or apparent authority, or color of law, of any foreign nation" subjects an individual to torture or extrajudicial killing "shall, in a civil action, be liable for damages to that individual." TVPA § 2(a)(1) & (2).
23. See, e.g., *Cabiri v. Assasie-Gyimah*, 921 F. Supp. 1189, 1199 (S.D.N.Y. 1996).
24. For example, in *Wiwa v. Royal Dutch Petroleum Co.*, 226 F.3d 88 (2d Cir. 2000), *cert. denied*, 121 S. Ct. 1402 (2001), the alleged activities and injuries occurred in Nigeria in connection with defendants' oil exploration activities in Nigeria. Defendants proposed Great Britain as the alternative forum (defendants were incorporated in Great Britain and the Netherlands). The court, however, held that neither country offered a forum any more convenient than the United States and that the court should defer to plaintiffs' choice of forum in the United States because some plaintiffs were U.S. residents. *Id.* at 102–07.
25. *Jota v. Texaco Inc.*, 157 F.3d 153, 159 (2d Cir. 1998), *subsequent determination by Aguinda v. Texaco Inc.*, 142 F. Supp. 2d 534 (S.D.N.Y. 2001) *aff'd as modified*, 303 F.3d 470 (2d Cir. 2002).
26. *Kadic*, note 11 *supra*, 70 F.3d at 238, quoting *Filartiga*, 630 F.2d at 887–88: "Because the [ATCA] requires that plaintiffs plead a 'violation of the law of nations' at the jurisdictional threshold, this statute requires a more searching review of the merits to establish jurisdiction than is required under the more flexible 'arising under' formula in section 1331. Thus, it is not a sufficient basis for jurisdiction to plead merely a colorable violation of the law of nations."

27. *Beanal v. Freeport McMoran*, 197 F.3d 161, 167 (5th Cir. 1999); *Amlon Metals, Inc. v. FMC Corp.*, 775 F. Supp. 668, 671 (S.D.N.Y. 1991); *Aguinda v. Texaco Inc.*, 142 F. Supp. 2d 534, 552 (S.D.N.Y. 2001) (finding plaintiffs' environmental-based ATCA claim "lack[ed] any meaningful precedential support and appear[ed] unlikely to survive a motion to dismiss.").
28. *Beanal*, note 27 *supra*, 197 F.3d at 167.
29. *Kruman v. Christie's Int'l Plc*, 129 F. Supp. 2d 620, 647 (S.D.N.Y. 2001), *aff'd in part, vacated in part and remanded by* 284 F.3d 384 (2d Cir. 2002) (appeal did not involve ATCA issues), *cert. denied*, 124 S. Ct. 27 (2003).
30. *Bigio v. Coca-Cola Co.*, 239 F.3d 440 (2d Cir. 2000).
31. *Beanal*, note 27 *supra*, 969 F. Supp. at 379.
32. *Id.*
33. 2002 WL 31063976, at \*10 (9th Cir. Sept. 18, 2002); *see also Sinaltrainal*, 256 F. Supp. 2d 1345, 1354–55 (dismissing ATCA claim against The Coca-Cola Company because plaintiffs could not allege that the company controlled or participated in the conduct resulting in plaintiff's death); *Bao Ge v. Li Peng*, 201 F. Supp. 2d 14, 21–22 (D.D.C. 2000), *aff'd*, 35 Fed. Appx. 1 (D.C. Cir. 2002) (dismissing ATCA claim against Adidas because plaintiffs failed to prove Adidas substantially participated in the alleged wrongful acts by the Chinese government).
34. *Wiwa*, note 24 *supra*, 226 F.2d at 96–98.
35. *See, e.g., Emory v. Grenough*, 3 U.S. 369, 370 (1797); *Hilton v. Guyot*, 159 U.S. 113, 163–64 (1895).
36. *See, e.g., Rivendell Forest Prods., Ltd. v. Canadian Forest Prods., Ltd.*, 810 F. Supp. 1116, 1119 (D. Colo. 1993).
37. *See, e.g., Sequihua v. Texaco Inc.*, 847 F. Supp. 61, 63 (S.D. Tex. 1994).
38. *See, e.g., Jota*, note 25 *supra*, 157 F.3d at 160.
39. *See* Fed. R. Civ. P. 19.
40. *Id.* Factors to be considered by the court in determining whether dismissal is warranted include (i) prejudice to any party or to the absent party; (ii) whether relief can be shaped to lessen the prejudice; (iii) whether an adequate remedy, even if not complete, can be awarded without the absent party; and (iv) whether there exists an alternative forum. *Id.*
41. *See, e.g., Jota*, note 25 *supra*, 157 F.3d at 161–62; *Bodner v. Banque Paribas*, 114 F. Supp. 2d 117, 136–38 (E.D.N.Y. 2000); *Nat'l Coalition Gov't of the Union of Burma v. Unocal, Inc.*, 176 F.R.D. 329, 357–58 (C.D. Cal. 1997).
42. *Jota*, note 25 *supra*, 157 F.3d at 161–62.
43. *See Doe v. Hyland Therapeutics Div.*, 807 F. Supp. 1117, 1126 (S.D.N.Y. 1992) ("It is well established that inability to implead possible third party defendants is a factor weighing against the retention of jurisdiction.").
44. The U.S. Supreme Court set forth the principle of the act of state doctrine more than one hundred years ago in *Underhill v. Hernandez*:
- Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.
- 168 U.S. 250, 252 (1897). *See also Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 401 (1964) ("The act of state doctrine in its tra-
- ditional formulation precludes the courts of this country from inquiring into the validity of the public acts a recognized foreign sovereign power committed within its own territory.").
45. *Bigio*, note 30 *supra*, 239 F.3d at 452, *quoting Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 520, 520–21 (2d Cir. 1985).
46. *Doe v. Unocal*, 963 F. Supp. 880, 892 (C.D. Cal. 1997) ("The continuing vitality of the doctrine depends on its capacity to reflect the proper distribution of functions between the judicial and political branches of Government on matters bearing upon foreign relations.").
47. *Bigio*, note 30 *supra*, 239 F.2d at 452; *Unocal*, note 46 *supra*, 963 F. Supp. at 893.
48. *Kadic*, note 11 *supra*, 70 F.3d at 250 ("[I]t would be a rare case in which the act of state doctrine precluded suit under section 1350."); *Unocal*, note 46 *supra*, 963 F. Supp. at 894 ("[I]n the context of jus cogens violations of international law, which, are, by definition, internationally denounced, the high degree of international consensus severely undermines defendants' argument that [the] alleged activities should be treated as acts of state.").
49. *Unocal*, note 46 *supra*, 963 F. Supp. at 894 ("Because nations do not, and cannot under international law, claim a right to torture or enslave their own citizens, a finding that a nation has committed such acts, particularly where, as here, that finding comports with prior conclusions of the coordinate branches of government, should have no detrimental effect on the policies underlying the act of state doctrine.").
50. *See Marbury v. Madison*, 5 U.S. 137, 169 (1803) (Marshall, J.) ("questions, in their nature political . . . can never be made in this court.").
51. 369 U.S. 186, 217 (1962) (identifying the following factors to be considered in assessing the political question defense: (i) "a textually demonstrable constitutional commitment of the issue to a coordinate political department," (ii) "a lack of judicially discoverable and manageable standards for resolving" the case; (iii) "the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion"; (iv) "the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government"; (v) "an unusual need for unquestioning adherence to a political decision already made"; and (vi) "the potentiality of embarrassment from multifarious pronouncements by various departments on one question").
52. *Id.*
53. *Goldwater v. Carter*, 444 U.S. 996, 998 (1979).
54. *See, e.g., Sarei v. Rio Tinto Plc*, 221 F. Supp. 2d 1116, 1193–98 (C.D. Cal. 2002) (dismissing ATCA claims brought by residents of Papua New Guinea against international mining group because claims interfered with the U.S. government's relations with the Papua New Guinea government).
55. TVPA § 2(c).
56. *See Wiwa*, note 24 *supra*, 2002 WL 319887, at \*19; *Deutsch v. Turner Corp.*, 324 F.3d 692, 717 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 105 (2003); *Iwanowa v. Ford Motor Co.*, 67 F. Supp. 2d 424, 462 (D.N.J. 1999).
57. *Bodner*, note 41 *supra*, 114 F. Supp. 2d at 134.

**Richard T. Marooney is a partner in King & Spalding LLP's New York litigation department. Mr. Marooney has represented corporate defendants in ATCA litigation.**



# U.S. Courts as International Courts of Claims: State Law as a Basis for Claims by Non-U.S. Plaintiffs, as Exemplified in *In Re World War II Era Japanese Forced Labor Litigation*

By Margaret K. Pfeiffer

## I. Introduction

The Alien Tort Statute, 28 U.S.C. § 1350, is not the only basis for cases brought in U.S. courts that have tenuous (at best) connections to the U.S. State laws can also provide a basis for such claims. Perhaps the premier example is the statutory scheme enacted by California to remedy what the California legislature viewed as insufficient compensation for victims of the forced labor of the Nazi regime and its allies.

## II. California's Statutory Scheme to Provide Compensation for World War II Forced Laborers

*In Re World War II Era Japanese Forced Labor Litigation* cases, MDL-1347,<sup>1</sup> involved consolidated cases brought on behalf of putative classes consisting of former U.S. and other Allied soldiers who were prisoners of war of Japan, as well as of Korean and Chinese nationals who were conscripted as laborers by Japan and sent to work in mines, shipyards and other industrial facilities throughout the Japanese Empire.

Although a few of the twenty-eight cases pleaded claims based on the Alien Tort Statute, most were brought in state court and alleged state law causes of action, such as tort, unjust enrichment, unfair business practices, *quantum meruit*, conversion, intentional infliction of emotional distress, constructive trust, false imprisonment and assault and battery. A number of cases also alleged violations of "international law." Most of the cases, however, were based on a California statute, section 354.6 of the California Code of Civil Procedure, passed in 1999, which created a new cause of action for persons who worked as forced or slave laborers in the territory of (or occupied by) the Nazis and their allies during World War II and the years leading up to it.<sup>2</sup>

Although the legislative history of section 354.6 shows a concern for providing relief only for victims of the Holocaust, the language of the statute is broad enough to encompass conduct in the Pacific Theatre as well, and both the District Court and the Ninth Circuit assumed that the statute did provide a cause of action for forced laborers, both civilians and POWs, in Asia.

## A. Cases in Both State and Federal Courts

All of the cases based on section 354.6 were filed in state court in California.<sup>3</sup> The defendants removed the cases to federal court—most to the Central District of California. Certain cases were remanded to state court; in other cases the motions to remand were denied. This led to the interesting situation of having essentially the same claims on behalf of substantially overlapping classes pending at the same time in state and federal courts. This was the result, among other things, of Ninth Circuit precedent that fails to acknowledge that the Supreme Court's decision in *Caterpillar Inc. v. Williams*,<sup>4</sup> permits removal on complete preemption grounds when Congress provides an administrative remedy, as it did in the War Claims Act of 1948,<sup>5</sup> and even when Congress provides no alternative at all to the state-law remedy.

While interesting, the pendency in both state and federal courts of cases raising the same claims predictably resulted, after three years of motion practice, in differing decisions. One state Court of Appeal upheld the constitutionality of the statute in cases brought by non-U.S.—*i.e.*, Korean and Chinese—nationals.<sup>6</sup> A second Court of Appeal found that the claims of U.S. and Allied nationals were barred by the multilateral Treaty of Peace with Japan, 8 September 1951,<sup>7</sup> to which forty-seven countries were signatories.<sup>8</sup> Both the District Court and the Ninth Circuit found both U.S. and foreign nationals' claims to be barred by federal law, applying somewhat different theories, as discussed below. The California Supreme Court has taken the two Court of Appeal cases on review and is expected to resolve the constitutionality of the statute as a matter of California law.

## B. Federal Preemption of State Causes of Action

The federal court cases were consolidated, on plaintiffs' motion, by the Judicial Panel on Multidistrict Litigation and transferred to Judge Vaughn Walker of the Northern District of California for pre-trial proceedings.<sup>9</sup>

### 1. The Treaty of Peace with Japan

Following transfer, the defendants moved to dismiss all cases on a number of grounds, the principal one being the Treaty of Peace. The Treaty represents a major distinction between the Holocaust and Asian

World War II cases. Unlike the case of Japan, there was no comprehensive peace treaty with Germany until after German reunification, due to the split of Germany into East and West and the Cold War.<sup>10</sup>

### a. Treaty Drafting and Negotiation

The Treaty was largely the product of United States foreign policy and the handiwork of John Foster Dulles, who was appointed as a Special Ambassador by President Truman to take charge of treaty negotiations and who had responsibility for its drafting as well.<sup>11</sup> Dulles, in addition to being the senior partner of Sullivan & Cromwell before he returned to government service, had been involved in drafting the Treaty of Versailles, with particular responsibility for the reparations provisions of that Treaty. Dulles shared with many others the belief that the reparations required by the Versailles Treaty were the fertile ground in which the seeds of World War II germinated. Thus Dulles was philosophically fully in accord with the basic tenet of U.S. policy with regard to the Treaty: that the Treaty should settle and discharge all claims against Japan and its nationals.<sup>12</sup>

Versailles was not, of course, the only reason for the U.S. policy. More immediately, the U.S., faced with the Cold War, the Korean War, and the destabilizing effects of the Chinese Civil War, as well as the continued territorial disputes between Russia and Japan, recognized the need for a democratic and economically stable Japan to serve as the fulcrum of a Far East policy and a physical base for U.S. and Allied troops.<sup>13</sup> The reparations policy also reflected U.S. concerns about the costs of the Occupation (which was nearly \$2 billion by the time of the Treaty)<sup>14</sup> which, in view of Japan's almost non-existent ability to support herself—much less pay reparations—meant that U.S. taxpayers would, in effect, foot the bill for any reparations Japan paid.<sup>15</sup> The U.S. viewed these concerns as so pressing that even contingent obligations for reparations were viewed as intolerable.

Given these concerns, it is not surprising that the reparations sections of the Treaty of Peace with Japan limited the types of reparations to be paid—principally though allowing each Allied country to seize and liquidate Japanese private and government property within its territory, including funds sequestered during the War.<sup>16</sup> The U.S. received approximately \$90 million through this mechanism: by far the lion's share of this amount consisted of property belonging to Japanese nationals, principally corporations. Even though Japan's economic condition was desperate, the Treaty effected the transfer of the greatest amounts of reparations payments made to that point in time,<sup>17</sup> and not surprisingly, China and Korea were the recipients of the greatest amount of property. In addition, article 16 of the Treaty

provided that Japanese assets held by neutral nations were to be confiscated and used to fund payments to Allied prisoners of war. This article, and the *travaux* and State Department papers underlying it, acknowledged the great suffering of prisoners of war. Because the United States was receiving much more than most of its Allies through the mechanism of article 14, the United States waived its right to receive payments pursuant to article 16.

### b. Treaty Ratification and the War Claims Act

The waiver provisions of the Treaty were opposed by a handful of Senators, who were concerned that article 14 cut off the rights of U.S. prisoners of war and others to make any claim in the courts. Senator Jenner proposed a reservation that would undo the waiver of claims provision and allow claims to be brought in U.S. courts.<sup>18</sup> The reservation was soundly defeated and the Treaty ratified without change.<sup>19</sup>

Instead of amending the reparations provisions of the Treaty, Congress acknowledged that it was the obligation of the United States itself to compensate its U.S. prisoners of war and civilian internees, and that each of the Allies had a commensurate obligation vis-à-vis its own nationals.<sup>20</sup> Following the route recommended by the State Department and the Senate Foreign Relations Committee, Congress amended the War Claims Act, 50 U.S.C. app. § 2004-2005.<sup>21</sup> The War Claims Commission ultimately paid approximately \$3,100 to one held prisoner for 3-1/2 years—from the Japanese capture of the Philippines until the end of war in the Pacific—having a present value of some \$20,000. This was, of course, in addition to military pay and benefits received by the prisoners of war.

## 2. Resolution of Claims by the Treaty

Having provided for specific reparations, the Treaty waived all other claims of any Allied nation or its nationals against Japan or any of its nationals. "Nationals" was specifically defined to include corporations.<sup>22</sup> This waiver, set out in article 14(b) of the Treaty, was, as noted above, deemed by the United States to be essential for Japan to be rebuilt. In addition to the foreign policy concerns previously noted, the U.S. was also well aware that, as the principal occupying power and the underwriter of Japan's economy during the Occupation, the United States—the U.S. taxpayer—would actually be paying any reparations bill.

Waiver of future claims was thus one of the bedrock provisions of the Treaty drafted by the U.S., and the one that faced the greatest opposition from a number of Allies, in particular Great Britain and the Philippines. The U.S. view ultimately carried the day but, as attested by documents collected in the Foreign Relations of the United States and more recently declassified docu-

ments, it took a lot of diplomacy to garner support for the reparations program backed by the U.S.<sup>23</sup>

The Treaty contained several other provisions of relevance to the lawsuits brought on behalf of classes putatively consisting of Korean and Chinese nationals (including, in one complaint, a class of all persons of Korean descent). Neither Korea nor China was a Treaty signatory. In Korea's case, this was so because Korea had been "annexed" by Japan in 1910 and was part of the Japanese Empire throughout the war; having never been at war with Japan, or an ally, it could not be a party to the Treaty. China had, of course, been a major ally in the Pacific Theatre, but civil war was raging in China by the time the Treaty was being drafted, and there was a split among the Allies—in particular between the U.S. and Great Britain—as to which China should sign the Treaty. Ultimately it was agreed that neither China would sign.

The Treaty nevertheless treated Korea in many ways as if it were a party.<sup>24</sup> Through article 4 of the Treaty, Japan ceded its claims to Korean territory and Korea was permitted to confiscate Japanese property in Korea. Article 4(a) of the Treaty obligated Japan to negotiate "special arrangements" with the Korean government to resolve the "claims . . . of [Korea] and [its] residents against Japan and its nationals," and the Treaty's reparations provisions were to provide the guidelines for such arrangements. Article 26 of the Treaty additionally required Japan to conclude settlements of war claims, on the same or substantially the same terms as provided by the Treaty, with China and certain other countries.

After years of negotiations, Japan did conclude treaties with Korea and both Chinas. Those treaties also contained waivers of claims provisions that included both claims against Japan and claims against Japanese nationals.

### III. The Court Decisions

#### A. The District Court Decision

This somewhat lengthy detour through the Treaty was, one hopes, not too distracting. It is important to understand the basic, relevant provisions of the Treaty, for the Treaty was important to the grounds of decision in both the federal District Court and the federal Court of Appeals (and in the state courts as well), although the analysis varied between the decisions in the Allied prisoner of war cases and the Korean/Chinese national cases in the District Court. The Treaty also formed the basis for the Ninth Circuit's conclusion on appeal that the California statute was preempted by the federal foreign affairs power.

Judge Walker, in the District Court, decided the Allied cases and the Korean/Chinese cases on different grounds, although, as the Ninth Circuit decision affirming dismissal of the cases shows, both groups of cases could have been disposed of on the grounds of the Korean/Chinese cases. The Allied cases were found to be barred by the provisions of article 14(b) of the Treaty, a position supported by the United States, which submitted a Statement of Interest and appeared at oral argument before the District Court.

The United States also took the position that the Korean and Chinese cases were barred by the Treaty—specifically by articles 4(a) and 26 of the Treaty. In the view of the United States, section 354.6 "would frustrate the federal policy established by the . . . Treaty of fostering resolution of all war claims . . . by state-to-state negotiations. . . ."<sup>25</sup>

Judge Walker, however, did not agree, noting that Korea and China were not signatories and concluding that the Treaty did not "occupy the field of non-signatory nations' claims."<sup>26</sup> Instead, he found that the California statute was unconstitutional as an encroachment on the foreign affairs power of the United States. The unconstitutionality of the statute was one of many grounds on which the defendants moved to dismiss the cases. In fact, the defendants had relied more heavily on grounds such as pre-emption, the political question doctrine,<sup>27</sup> and the bilateral treaties Japan entered into with Korea and China, in part because they were mindful of the courts' oft-expressed reluctance to hold state statutes unconstitutional and in part because the Ninth Circuit had recently upheld another California statute—which required disclosure of information about World War II era insurance policies written in Europe, finding that the other statute did not invade the federal realm. Among the grounds relied on by the Ninth Circuit in that case was the fact that the statutory section in question related to insurance, a commercial field historically and congressionally left to state control, and that it was a "reporting" requirement, not a basis for liability.<sup>28</sup>

Having taken the view that the Treaty did not itself resolve the claims of the Korean and Chinese plaintiffs, the District Court dismissed those cases on the ground that the California statute was unconstitutional as applied because it "infringes on the exclusive foreign affairs power of the United States." According to Judge Walker, the Constitution prevents California from engaging "in the uniquely federal foreign policy function of addressing claims for reparations that arise in the aftermath of a war," regardless of whether there is a treaty dealing with the issue.<sup>29</sup> In so holding, the Court distinguished the *Gerling* decision.

## B. The Ninth Circuit Decision

The Ninth Circuit affirmed the District Court's judgment of dismissal of all twenty-eight consolidated cases.<sup>30</sup> Like the District Court, the Ninth Circuit had the benefit of the views of the United States, which submitted, and argued orally, a brief *amicus curiae* in the Ninth Circuit, primarily addressing the U.S. foreign policy and Treaty issues.

The Ninth Circuit's earlier decision in the *Gerling* case was viewed as the biggest question mark as to how the Court would treat Judge Walker's ruling that section 354.6 was an unconstitutional invasion of the federal foreign affairs power. In *Gerling*, the Ninth Circuit held that there was no federal preemption of a California statute requiring insurers doing business in California to provide disclosures about insurance policies sold in Europe and in effect between 1920 and 1945, including information about whether benefits were paid under the policies. While the cases were distinguishable on multiple grounds—among them the fact that the statute at issue in *Gerling* did not purport to create a cause of action—some viewed the *Gerling* decision as evidence of the Ninth Circuit's reluctance to gainsay California's power to provide for Holocaust victims and other World War II forced laborers. In any event, the panel considering section 354.6 had no trouble distinguishing *Gerling*: in affirming dismissal of both the U.S. and foreign plaintiffs' claims, the panel (in an opinion by Judge Stephen Reinhardt) recognized that the basis for preemption was much stronger as to section 354.6 than for the statute at issue in *Gerling*.

In assessing where the line between federal and state power is properly drawn, the Ninth Circuit focused on the war-related nature of these claims. The Court observed that, of the eleven clauses of the Constitution dealing with the foreign affairs power of the Executive and Legislative Branches, seven enumerate war powers, specifically including "settling war," while "[m]ost of the Constitution's express limitations on States' foreign affairs power also concern war."<sup>31</sup> The Court concluded that the power "to resolve war, including the power to establish the procedures for resolving war claims" is "part of the inner core" of the "foreign relations power that is denied to the States."<sup>32</sup>

While the panel relied on the Supreme Court's decision in *Zschernig v. Miller*<sup>33</sup>—a case often described as standing for the proposition that state law can be preempted by the federal foreign affairs power even where the federal government has not acted in any way to exercise its own powers<sup>34</sup>—it found that, in fact, the federal government had "already exercised its own exclusive authority to resolve" World War II, "including claims arising out of it," through the Treaty.<sup>35</sup> The finding that the chosen resolution did not create any "pri-

vate right of action against Japan or its nationals" is especially significant under the rule of law announced in *Ware v. Hylton*, mentioned in note 23 *supra*.<sup>36</sup> The Court also found that the Treaty did not authorize any state "to create such a right."<sup>37</sup> In the Court's view, section 354.6 would "modify" the federal resolution of claims arising from World War II; ample authority forbids state laws to have such an effect, leading to the Court's holding that the statute was preempted.<sup>38</sup> This holding applied equally to both the Allied cases and the Korean and Chinese plaintiffs' suits; it was "immaterial" whether plaintiffs were nationals of non-signatory states, because the foreign affairs power was interfered with regardless of the nationality of those seeking redress.<sup>39</sup>

The Ninth Circuit, aware that *certiorari* had been granted in the *Gerling* case, did not immediately issue its mandate. It did, however, deny both rehearing and a later request for reconsideration.

## IV. The Supreme Court's Treatment of Foreign Affairs Preemption

At the end of last term, prior to issuance of the mandate by the Ninth Circuit in the *World War II Era* cases, the Supreme Court issued a decision that reversed the Ninth Circuit's *Gerling* decision, holding that California's Holocaust insurance statute was preempted by federal law.<sup>40</sup> In a 5-4 decision authored by Justice Souter—with the rather unusual line-up of dissenters Justices Ginsburg, Stevens, Scalia, and Thomas—the Court rejected California's characterization of its statute as a "consumer protection" regulation designed to inform California residents about insurers who refused to pay claims, finding that the statute's aim was instead to "assist several thousand Holocaust survivors" to pursue reparations claims. The court described "Holocaust-era insurance claims" as falling "within the subject of reparations, which became a principal object of Allied diplomacy soon after the war."<sup>41</sup>

The Court extensively described the formation of the German Foundation Agreement "signed by President Clinton and German Chancellor Schröder in July 2000, in which Germany agreed to enact legislation establishing a foundation . . . to be used to compensate all those 'who suffered at the hands of German companies during the' Nazi era."<sup>42</sup> The Court contrasted that federal initiative with California's insurance statute, which was "designed to 'ensure the rapid resolution' of unpaid insurance claims, 'eliminating the further victimization of these policyholders and their families. . . .'"<sup>43</sup>

Surveying prior preemption decisions of the Supreme Court, Justice Souter found strong support for the "principal argument for preemption" of the California statute: that it "interferes with foreign policy of the

Executive Branch, as expressed principally in the executive agreements with Germany, Austria, and France” setting up the German Foundation.<sup>44</sup> The starting point was the proposition—as to which the Court found “no question”—“that at some point an exercise of state power that touches on foreign relations must yield to the National Government’s policy, given the ‘concern for uniformity in this country’s dealings with foreign nations’ that animated the Constitution’s allocation of the foreign relations power to the National Government in the first place.”<sup>45</sup> That point was reached here, the Court found, because, even though the cases involved ostensibly private claims against private companies, “wartime claims against even nominally private entities have become issues in international diplomacy”; “untangling government policy from private initiative during war time is often so hard that diplomatic action settling claims against private parties may well be just as essential in the aftermath of hostilities as diplomacy to settle claims against foreign governments.”<sup>46</sup> While the federal government presented a diplomatic solution to the issues of compensation for Holocaust victims, “California has taken a different tack of providing regulatory sanctions to compel disclosure and payment, supplemented by a new cause of action for Holocaust survivors if the other sanctions should fail.”<sup>47</sup> The collision between “[t]he express federal policy” and the California statute “are alone enough to require state law to yield.”<sup>48</sup>

## V. Conclusion

These cases, while somewhat atypical in subject matter, reflect the increased willingness of state legislatures to pass legislation aimed at righting wrongs or ills that took place far beyond their borders. The upholding of the constitutionality of section 354.6 by the California trial courts and by the Courts of Appeal<sup>49</sup> shows the willingness of state courts to uphold state statutes, although the California Supreme Court may take a different course.

It is striking that the result of the two California state Court of Appeal rulings is that U.S. persons’ claims were dismissed, while the claims of millions of Chinese and Korean plaintiffs have been allowed to proceed in the courts of California, based solely on California law, most prominently a statute passed many decades after the fact. Although the California state Court of Appeal did not address the common law and other California statutory claims asserted by these plaintiffs, the result of the ruling may be that such claims, too, may be raised in state court by plaintiffs whose injuries arose elsewhere and were caused by persons with no tie to California.

It remains to be seen whether these cases are a sport or a harbinger of increasing the role of state legislatures and courts in transforming U.S. courts into international claims courts.

## Endnotes

1. *In re World War II Era Japanese Forced Labor Litig.*, 114 F. Supp. 2d 939 (N.D. Cal. 2000); *In re World War II Era Japanese Forced Labor Litig.*, No. MDL-1347 (N.D. Cal. 8 Feb. 2001); *In re World War II Era Japanese Forced Labor Litig.*, 164 F. Supp. 2d 1153 (N.D. Cal. 2001); *In re World War II Era Japanese Forced Labor Litig.*, 164 F. Supp. 2d 1160 (N.D. Cal. 2001). All of these decisions were affirmed by *Deutsch v. Turner Corp.*, 324 F. 3d 692 (9th Cir. 2003), petition for cert. filed, *Kim v. Ishikawajima Harima Heavy Indus., Ltd.*, No. 02-1773 (2 June 2003), *Tenney v. Mitsui & Co.*, No. 02-1776 (4 June 2003), *Ma v. Kajima Corp.*, No. 02-1778 (4 June 2003), *Saldajeno v. Ishihara Sangyo Kaisha, Ltd.*, No. 02-1784 (4 June 2003).
2. § 354.6. Compensation for slave and forced labor
  - (a) As used in this section:
    - (1) “Second World War slave labor victim” means any person taken from a concentration camp or ghetto or diverted from transportation to a concentration camp or from a ghetto to perform labor without pay for any period of time between 1929 and 1945, by the Nazi regime, its allies and sympathizers, or enterprises transacting business in any of the areas occupied by or under control of the Nazi regime or its allies and sympathizers.
    - (2) “Second World War forced labor victim” means any person who was a member of the civilian population conquered by the Nazi regime, its allies or sympathizers, or prisoner-of-war of the Nazi regime, its allies or sympathizers, forced to perform labor without pay for any period of time between 1929 and 1945, by the Nazi regime, its allies and sympathizers, or enterprises transacting business in any of the areas occupied by or under control of the Nazi regime or its allies and sympathizers.
    - (3) “Compensation” means the present value of wages and benefits that individuals should have been paid and damages for injuries sustained in connection with the labor performed. Present value shall be calculated on the basis of market value of the services at the time they were performed, plus interest from the time the services were performed, compounded annually to date of full payment without diminution for wartime or post-war currency devaluation.
  - (b) Any Second World War slave labor victim, or heir of a Second World War slave labor victim, Second World War forced labor victim, or heir of a Second World War forced labor victim, may bring an action to recover compensation for labor performed as a Second World War slave labor victim or Second World War forced labor victim from any entity or successor in interest thereof, for whom that labor was performed, either directly or through a subsidiary or affiliate. That action may be brought in a superior court of this state, which court shall have jurisdiction over that action until its completion or resolution.
  - (c) Any action brought under this section shall not be dismissed for failure to comply with the application statute of limitation, if the action is commenced on or before December 31, 2010.
3. The earliest-filed case pre-dated section 354.6 and was brought in federal court in the Northern District of California. *Levenberg v. Nippon Sharyo Ltd.*, CV99-1554 (N.D. Cal., filed 31 March 1999). A second case filed in federal court was voluntarily dismissed after the defendants moved for dismissal; the dismissal was conditioned on the named plaintiffs being barred from instituting another suit elsewhere. *Jackfert v. Kawasaki Heavy Indus.*, CN99-1019JP (D.N.M., filed 13 Sept. 1999).

4. 482 U.S. 386, 393 (1987).
5. 50 U.S.C. app. § 2001 *et seq.*
6. *Taiheiyō Cement Corp. v. Superior Court*, 105 Cal. App. 4th 398 (2003).
7. 3 U.S.T. 3169.
8. *Mitsubishi Materials Corp. v. The Superior Court of Orange County*, 106 Cal. App. 4th 39 (2003).
9. Plaintiffs requested that the cases be assigned to Judge Manuel L. Real in the Central District: he had presided over the *Marcos* cases, which were based on the ATS, but which plaintiffs argued were very similar to their cases. Motion for Transfer of Actions to a Single District for Consolidation and Coordinated Pretrial Proceedings, 23 March 2000, MDL-1347 (J.P.M.L.) (referring to Judge Real as “the most experienced jurist in the Ninth Circuit in handling human rights issues” for his handling of the “*Ferdinand E. Marcos Human Rights Litigation*, MDL No. 840, the largest human rights case ever litigated in the United States courts.”). Defendants opposed the consolidation; summary judgment motions had already been filed in two of the cases, and the motions had been argued within days of the request for MDL treatment. Defendants believed that those motions would be promptly decided by Judge Vaughn Walker and that the collateral estoppel effect of that decision would provide more expeditious resolution of the cases than the MDL process.
10. For a detailed exposition of the German treaty chronology, see *Iwanowa v. Ford Motor Co.*, 67 F. Supp. 2d 424 (D.N.J. 1999); *Burger-Fischer v. Degussa AG*, 65 F. Supp. 2d 248 (D.N.J. 1999). See also *Am. Ins. Ass’n v. Garamendi*, 123 S. Ct. 2374 (2003).
11. See S. Exec. Rep. No. 82-2(1952).
12. For a full—and fascinating—description of the Treaty process, see *Foreign Relations of the United States 1951*, Vol. VI, Asia and the Pacific (1977) Vol. XIV, Japan.
13. See Dulles Statement, 11 July 1951, House Foreign Affairs Comm. Exec. Sess.
14. See S. Exec. Rep. No. 82-2.
15. Dulles Letter, 31 January 1952, S. Foreign Relations Comm. Hearing. See also Dulles Statement, 9 March 1951, S. Foreign Relations Comm. Exec. Sess.
16. The U.S. had previously “frozen” property pursuant to the Trading With the Enemy Act, 50 U.S.C. app. § 1-44. The general principle of law is that any funds still frozen at the end of a war must be returned to their owners on cessation of hostilities. See generally Littauer, *Confiscation of the Property of Technical Enemies*, 52 Yale L.J. 739 (1943).
17. 98 Cong. Rec. 2454 (1952).
18. 98 Cong. Rec. 2865, 2567-71 (1952).
19. 98 Cong. Rec. 2571 (1952).
20. See, e.g., S. Exec. Repts., No. 82-2 at 13.
21. *Japanese Peace Treaty and Other Treaties Relating to Security in the Pacific: Hearing Before the S. Comm. on Foreign Relations*, 82d Cong. 2d Sess. 147 (1952); S. Exec. Rept. No. 82-2, at 13–14 (1952).
22. Treaty of Peace with Japan, 8 Sept. 1951, art. 4, 3 U.S.T. 3169.
23. It should be noted that the Treaty’s approach to reparations—waiving all claims whose payment is not specifically provided for in the Treaty itself—is precisely the result that would have been effected by operation of law, as it has been in effect since the founding of the country, had the Treaty not specifically provided for a waiver of claims. As set out in *Ware v. Hylton*, 3 U.S. 199, 230 (1796), a case involving private claims arising out of the Revolutionary War, the rule is that “[A]fter peace is concluded, neither the matter in dispute nor the conduct of either party, during the war, can ever be revived, or brought into contest again. All violences, injuries, or damages sustained by the government, or people of either, during the war, are buried in oblivion” except to the extent the Treaty specifically preserves them.
24. U.S. Department of State, *Record of Proceedings of the Conference for the Conclusion and Signature of the Treaty of Peace with Japan*, at 85 (1951).
25. Statement of Interest of the United States, at 14, 17 (filed 6 December 2000, MDL-1347).
26. Order No. 10, at 10 (filed 17 September 2001, MDL-347).
27. Several of the German cases were dismissed on the ground that the issues raised were ones of war reparations which were non-justiciable. In particular, two opinions from the District Court in New Jersey contain extensive discussions of this doctrine. See *Iwanawa v. Ford Motor Co.*, 67 F. Supp. 2d 424 (D.N.J. 1999); *Burger-Fischer v. Degussa AG*, 68 F. Supp. 2d 248 (D.N.J. 1999).
28. *Gerling Global Reins. Corp. of Am. v. Low*, 240 F.3d 739 (9th Cir. 2001). *Gerling* involved the Holocaust Victim Insurance Relief Act, Cal. Ins. Code §§ 13800-138807.
29. Order No. 10, at 24.
30. The Ninth Circuit also affirmed dismissal of *Deutsch v. Turner Corp.*, No. CV 00-4405 SVW, 2000 WL 33957691 (C.D. Cal. 25 Aug. 2000), which alleged World War II wrongs by German corporations. The plaintiff in *Deutsch* had eschewed the settlement brokered by the U.S. through the German Foundation and appealed dismissal of his claim; his appeal, which also raised the issue of the constitutionality of section 354.6, was consolidated for argument with the Japanese cases.
31. *Deutsch v. Turner*, 324 F.3d 692, 711 (9th Cir. 2003).
32. *Id.*
33. 349 U.S. 429 (1968)
34. *Garamendi*, 123 S. Ct. at 2388. See also *Nat’l Foreign Trade Council v. Natsios*, 181 F.3d 38, 51 (1st Cir. 1999).
35. 324 F.3d at 712.
36. *Id.* at 714.
37. *Id.*
38. *Id.* at 714–15.
39. *Id.*
40. *Am. Ins. Ass’n v. Garamendi*, 123 S. Ct. 2374 (2003).
41. 123 S. Ct. at 2380.
42. *Id.* at 2381 (quoting the German Foundation Agreement).
43. *Id.* at 2384 (quoting California Senate Committee on Insurance report).
44. *Id.* at 2386.
45. *Id.* (citations omitted).
46. *Id.* at 2387.
47. *Id.* at 2391.
48. *Id.* at 2392.
49. Although the Court of Appeal for the Fourth Appellate District held that the plaintiffs’ claims were barred by the Treaty, it specifically declined to address the issue of the statute’s constitutionality, noting the conflict between the Ninth Circuit and the Court of Appeal for the Second Appellate District as to constitutionality. *Mitsubishi Materials Corp.*, note 8 *supra* 106 Cal. App. 4th at 42 nn.2 & 3.

**Margaret K. Pfeiffer is a partner in the Washington, D.C., office of Sullivan & Cromwell.**

# “Spam Wars”: A European Legal Approach and the Need for an International Cooperation

By Charles-Edouard Renault

## I. Introduction

The amount of “junk mail” in our e-mail boxes never ceases to increase. Anybody whose e-mail address is publicly available receives a lot of unsolicited commercial e-mails. This new technique of canvassing, usually called “spamming,”<sup>1</sup> is considered by certain professionals as a curse and as a real obstacle in the development of e-commerce and particularly of e-mail marketing.

Spamming was, at its beginning in 1994 in the USA,<sup>2</sup> the activity of a small number of people. It has tended to become a bigger problem for several reasons:

- There is with spamming a growing concern over the uncontrolled trading of personal data and aggressive advertising. E-mail marketing can be a powerful tool when used in a targeted and responsible way. But when used without respect for addressees’ privacy rights or preferences, which is the case of “spam,” it can cause serious offense and nuisance to individuals as well as companies.
- Spamming is harmful for the Internet users who support the expenses of reception of messages and spend a large amount of time cleaning their e-mail in-boxes.
- Spam undermines the confident use of the Internet users in general.
- Spam also generate problems for Internet service providers (ISPs) and connected entities, whether public or private, whose networks can be blocked or slowed down.

Public regulation is only a small part of the answer, and national or regional legislation an even smaller one. It may reinforce the rights available to individuals, at least within Europe. But also international good practices in e-mail marketing, technical protections, as well as international judicial cooperation between states will have a role in fighting this worldwide phenomenon. For all this, one should define “spam” in a common way.

## II. What Is Spam?

### A. General Understanding

Everybody has his or her own definition of spam. For instance, some Internet users consider themselves

to be victims of spam when they receive a humorous e-mail dispatched to another recipient from a relative. Others consider as spam a newsletter sent from a Web site to which they had subscribed previously but which they had forgotten about (for example, a French Internet user complaining about receiving a newsletter from the French Senate). Others even consider that they are “spammed” when they receive by e-mail the position of their banking account or their phone bill. . . .

Generally speaking, the term “spam” is used to designate unsolicited e-mail that is often of an advertising nature.

### B. Factual Description

Spam is usually sent on the basis of irregular collections of e-mails, either by means of search engines in public Internet spaces (web sites, discussion groups, distribution lists, chat), or where e-mail addresses have been communicated to third parties without prior information to those concerned and irrespective of their right to oppose this communication. Usually, these messages do not have a valid dispatch or “reply to” address and the “unsubscribe” address or hyperlink is non-existent or invalid. Many spams are still disseminated through the Internet by using the “open-relay” option opened in e-mail servers, which deliver it to all e-mail accounts they store. According to a Forrester Research study published in May 2001, more than forty percent of e-mail servers worldwide were still configured to allow “open-relay” distribution of messages, an inheritance of the first age of the Internet.

The most sophisticated spammers currently use a different e-mail address for each message, automatically created from a main free e-mail account through a Web mail service. Their messages consist of a picture inserted in an html message, in order to avoid any filtering software using key words. A hyperlink is inserted at the bottom of the message, in order to allow the recipient to “unsubscribe.” This link leads to a web page which seems to allow removal of e-mails from the database. But in reality, as every message is sent with a particular e-mail address, the option to allow removal in order to refuse receiving messages from this specific e-mail is useless.

### C. Why Is Spam a Problem?

In June 2003, around forty-five percent of global e-mail traffic was spam, according to the company Bright-

mail. The growth of spam is very worrying: It is expected that spam will grow to more than fifty percent of global e-mail traffic before the year 2003 is over and that by 2007 this may increase to seventy percent.<sup>3</sup>

Spam is a problem not only for obvious privacy reasons, but also because it is very annoying, time-consuming and money-consuming. It creates important costs for industry. Efficiency at work is undermined because inboxes are full of spam. The Research Institute Ferris has estimated that in 2002, spam cost European companies 2.5 billion euros just in term of lost productivity.

Another consequence of spam is that it undermines user confidence, which is a danger for successful e-commerce or e-services. Spam tends to create the negative habit of deleting automatically every commercial message. Moreover, spamming leads to establishing blacklists of e-mail servers even though they do not practice spamming but are victims of hacking. According to a Return Path study published in July 2003, more than seventeen percent of solicited e-mails are blocked by ISPs (notably forty percent of distant selling and thirty-three percent of software companies' solicited messages).

A specific regulation is therefore part of the answer to spam.

### III. Searching for a Legal Definition

#### A. Not All Unsolicited Commercial Messages Are "Spam"

An unsolicited commercial message has two characteristics: its commercial nature and the fact that it is unsolicited. A first pragmatic legal definition of spam would consist of considering that spam is unsolicited e-mailing. However, in most cases, this definition also applies to electronic marketing, which is, by nature (finding new customers or offering new services to existing customers) rarely solicited. Therefore, one should consider that spam is more than just unsolicited e-mailing, unless one assumes that marketing on the Internet is spam (which some public regulators sometimes contend).

Thus, what would be a solicited commercial e-mail? An e-mail sent to:

1. An Internet user who expressly asked for receiving commercial communications?
2. A customer who previously gave to a company his e-mail address either by subscribing to services or by purchasing goods on-line?
3. An Internet user whose e-mail address is publicly available on the Web (in news groups, web

sites, e-mail directories, domain names registers' databases)?

The three "solicitation" concepts described above illustrate respectively (1) the new European position on electronic marketing; (2) the previous European position; and (3) the current federal US legal framework.

Spam essentially differs from unsolicited commercial messages by its unfair nature. Therefore, the main question to ask, in order to distinguish between spam and the other forms of commercial communication, is from a European perspective, "How are e-mail addresses collected and/or used?"

#### B. Is Spam E-mailing to Individuals Whose Address E-mail Has Been Used Unfairly?

Yes. But not only. According to the CNIL<sup>4</sup> reports relating to spamming (published on 14 October 1999 and 21 November 2002), spamming or spam is the *massive* and sometimes *repetitive* sending of *unsolicited* commercial e-mails to individuals with whom the sender has *any prior contact* and whose e-mail address has been *obtained and used irregularly*.

Under an analysis based purely on European privacy law, one should delete from this first European definition of spam (October 1999) the following criteria: "massive"; "repetitive"; and "without any prior contact." Thus, European data protection directive 95/46/EC dated 24 October 1995 recognizes rights to any individual whose personal data is processed in the E.U., no matter whether one million people or only one person receive a single or several thousand "spam." Furthermore, this Directive allows the transmission of personal data between companies, inasmuch as data subjects are informed about it and are in a position to make prior objection to it. The "prior contact" criteria was therefore inaccurate as far as European privacy laws adopted before July 2002 were concerned.

Therefore, according to European privacy law Spam is an unlawful commercial use of an e-mail address, i.e., the sending of an e-mail to an individual whose address (or mobile phone number) has been irregularly obtained (unfair collection and/or disclosure) and used (without the data subject's opportunity to object to the commercial use of his data).

### IV. The Legal Framework to Unsolicited E-Mailing

There has been, up to now, no specific French legislation in force directly to prevent spamming, since the phenomenon can be addressed by data protection and computer hacking laws. However, a specific European legal framework has been set up since 1995 against the commercial use of personal data.



## A. In France

### 1. French Privacy and Data Protection Laws

The practice of spamming breaches the provisions of the Directive 95/46/EC on data protection<sup>5</sup> (the "Directive 95/46/EC") as well as the French law of 6 January 1978 known as *Loi Informatique et Libertés*<sup>6</sup> (the "Law") on at least three points.

- Firstly, the method of automatically collecting addresses that serves spamming operations is clearly illegal since it is an unfair way of collecting personal data without prior information to data subjects of their rights (to access, modify or delete their data), the purpose of processing of their data, the identity of the controller of their data, etc. In the majority of cases, spammers use tools called "mail extractors," allowing collection of the electronic addresses published in public spaces of the Internet to make solicitation files at the least cost.
- Secondly, spammers do not allow effective use of the right to object. Article 14 of the Directive 95/46/EC and Article 26 of the Law acknowledge that every person has the right to oppose the commercial use of such person's data or the transmission of these to third parties. Generally, in spam no means of opposition are offered to persons and when such means are offered, they are not efficient, or worse, they are used to confirm the electronic address of the Internet user.

These two first practices may be sanctioned in France under article 226-18 of the French Criminal Code, which provides that the collection of data by fraudulent, unfair or unlawful means, or the processing of personal data despite the data subject's opposition, is punishable by five years imprisonment and a fine of EUR 300,000.

- Finally, the processing of personal data is subject to a prior notification to the CNIL, in compliance with article 16 of the French Law. Any breach of this obligation is punishable under article 226-16 of the French Criminal Code. Carrying out the automated processing of data containing names without having observed the preliminary formalities laid down by law is punishable by three years imprisonment and a fine of EUR 45,000, even when committed negligently and without criminal intent.

### 2. French Computer Hacking Law

The practice of spamming also breaches the provisions of the computer hacking law. Spamming, by the massive dispatch of messages, which is called "mail

bombing" (in one case, 315,000 in one night), tends to disrupt seriously the IT systems of Internet service providers or other companies. This practice may be sanctioned under article 323-26 of the French Criminal Code and is punishable by three years imprisonment and a fine of EUR 45,000. On 20 February 2001, the Tribunal de Grande Instance of Lyon<sup>7</sup> condemned an employee under the provisions of article 323-26 of the Criminal Code, since he sent to his employer a large amount of e-mails with the intent to block or slow down the network.

## B. At the European Level

The European Union has been debating the question of how to protect citizens from unsolicited commercial communication for eight years. The debate has centered around two alternative concepts, whether for fax or e-mail marketing:

- *The "opt-out" approach (or right to object):* Those who do not wish to receive commercial e-mails that they did not request in advance should be able to register this preference with a particular company or through a national opt-out register. It should be possible to oppose receiving any commercial message, at the moment of providing personal information to a company or, later, while receiving a commercial communication.
- *The "opt-in" approach (or prior consent):* It should be possible to send commercial communications by fax or by e-mail only to those who have given their prior and explicit consent to receive such messages. The Directive 95/46/EC<sup>8</sup> provides a strict definition of consent as a "freely given specific and informed indication of his wishes by which the data subject signifies his agreement." The web surfer's consent has to be express. For example, consent could be indicated by ticking a box in a personal registration form to allow further commercial solicitation.

This debate ended with the European Directive 2002/58 of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sectors, which adopts a strict opt-in approach. It is necessary to outline the entire legal framework applicable to unsolicited commercial message in Europe in order to understand the parameters of the debate.

### 1. The General Directive 95/46/EC

This Directive provides, in articles 6, 7, 10, 11 and 14, that personal data may not be processed unless they are collected and processed fairly and for specific and legitimate purposes. This Directive adopts the "opt-out" approach.

Persons receiving unsolicited e-mails are offered by Article 14 of the Directive<sup>9</sup> the possibility to object, at the moment they provide their personal information to a company or, later, while receiving a commercial communication, to the commercial use of their personal data or the transfer of those data to third parties for commercial use. The weakness of the Directive was that it did not state precisely when data subjects should be in a position to exercise their right to object to the commercial use of their personal data.

## **2. The Telecommunication Directive 97/66/EC<sup>10</sup>**

This Directive provides, in Article 12, that “the use of automated calling systems without human intervention (automatic calling machine) or facsimile machines for the purposes of direct marketing may only be allowed in respect of subscribers who have given their prior consent.” When direct marketing is done by fax or automatic calling machine, the Directive adopted the “opt-in” approach. When other direct marketing methods are concerned, the Directive left to the Member States the option to choose between an “opt-in” or an “opt-out” approach.

Further to the Telecommunication Directive, Germany, Austria, Denmark, Finland and Italy have adopted the prior consent system for e-mail, since they consider direct marketing by fax or automatic calling machine to be similar to direct marketing by e-mail, because it is automated and is costly for recipients. France had chosen an “opt-out” system. The situation in Europe was therefore a hybrid of the two approaches.

## **3. The Distance Selling Directive 97/7/EC<sup>11</sup>**

This Directive repeated in Article 10 the same distinction as the Telecommunication Directive.

## **4. The Electronic Commerce Directive 2000/31/EC<sup>12</sup>**

This Directive laid down two technical requirements for the sending of unsolicited electronic messages.

Article 7.1 provided that “Member States which permit unsolicited commercial communication by electronic mail shall ensure that it shall be identifiable clearly and unambiguously as such as soon as the message is received by the recipient.”

This article institutes an obligation for any sender of unsolicited commercial e-mail to specify expressly and clearly the nature of the message (discounts, premiums, gifts, games, promotions) so that the recipient is able to identify it immediately as a commercial message and can thus delete it without the need to read it. The recipient must have as well the possibility to refuse pro-

motional messages in the future.<sup>13</sup> That’s why all providers of information society services must give at least their name, geographic address, e-mail contact details and the particulars of any supervisory authority to which they belong so that recipients of unwanted e-mails can readily take action to avoid receiving such communications in future.

Article 7.2 states that, “Without prejudice to Directive 97/7/EC and Directive 97/66/EC, Member States shall take measures to ensure that service providers undertaking unsolicited commercial communications by electronic mail consult regularly and respect the opt-out registers in which natural persons not wishing to receive such commercial communication can register themselves.”

By creating opt-out registers through which individuals can indicate that they do not want to receive unsolicited commercial communications, the Electronic Commerce Directive promoted the “opt-out” approach. It prohibited commercial electronic communications sent to addressees who have specified their objection in national public registers and consequently imposed upon senders the duty to consult regularly the registers before sending commercial messages. But in terms of e-mailing, since these registers would have strictly been national, they could not be the most effective way of dealing with cross-border communications in a global market. This technique was also unmanageable because the updates of registers in real-time at the European level were impossible: how could an online advertiser be certain that an e-mail addressee has not registered on an opt-out registry? In which European country? What is the nationality of an e-mail address? For example, when processing meta26@hotmail.com e-mail address, how does one know if it is a French, German, Italian, or other national e-mail address ?

There seemed to be confusion as to what was and was not legal in Europe. The sending of unsolicited commercial e-mail was governed by a combination of four Directives and two categories of national legislations. Thus the legal situation was a hybrid of two approaches. A clarification of the issue at the European level was urgently required, as described in a report drafted for the European Commission by Serge Gauthronet, privacy expert and Etienne Drouard, former member of the CNIL and now a lawyer at Gide Loyrette Nouel. The most recent Directive 2002/58/EC was an effort to clarify the situation in Europe.

## **5. The Electronic Communication Directive 2002/58/EC<sup>14</sup>**

This most recent directive is intended to replace Directive 97/66/EC. It adopts the “opt-in” system based on prior consent and is intended to unify the sit-

uation in Europe. The Directive requires implementation in Member States by 31 October 2003 and they must make the enforcement of the “opt-in” a priority.

Compared to the Telecommunication Directive 97/66/EC, this new Directive extends controls on unsolicited direct marketing to all forms of electronic communications, including unsolicited commercial electronic mail, which includes e-mail, as well as SMS (in mobile telecommunications) or instant messengers. This kind of e-mail will be subject to a prior consent requirement. The rule is that the receiver is required to agree to it in advance, except in the very strict context of an existing customer relationship, where companies may continue to e-mail on an “opt-out” basis.

Therefore, the “opt-in” rule applies to unsolicited direct marketing by means of automated calling systems without human intervention, fax, and phone and now to unsolicited e-mail and SMS marketing. The “opt-in” approach has been chosen. But this choice is not as clear as it appears. The Directive introduces an exception and leaves a possibility of choice for Member States.

#### **a. The exception**

E-mails may be sent on an “opt-out” basis in the context of an existing customer relationship, where:

- the sender obtains the addressee’s contact details (e-mail or mobile phone number) directly from the data subject, . . .
- . . . in the context of the sale of a product or service, and . . .
- in accordance with the data processing rules in the Data Protection Directive 95/46/EC;
- the sender is marketing its own products or services, . . .
- . . . which must be similar to those previously provided to the data subject; and
- the addressee was able to opt out of future marketing when he gave his contact details and he must also be able to opt out when receiving any new message, in an easy way and free of charge.

#### **b. A possibility of choice for Member States**

This regime is intended for marketing to individuals. However, Member States can extend it to business-to-business direct marketing. Concretely, it allows Member States discretion over what level of protection should be extended to corporate subscribers in relation to all forms of unsolicited commercial communications.

### **C. Implementation of Directive 2002/58/EC Raises a Number of Questions**

#### **1. In Any Member State**

##### **a. What is a customer relationship for e-mail marketing purposes?**

Firstly, should customer relationships for these purposes be confined to situations only where the e-mail addressee has previously bought something or should it apply also to prospective customers who gave their contact details without purchasing goods or services? The text of the Directive does not make it clear. But this is an issue that is clearly going to be of concern for businesses that may have legitimately obtained an e-mail address directly from an Internet user without actually selling its products or services.

##### **b. How should the “Similar Products” criterion be interpreted?**

The Directive’s condition that opt-out e-mail marketing must be on products similar to previously purchased ones is intended to reinforce the principle that the “opt-out” regime should only apply to targeted marketing where the products and services concerned will be of interest to the addressee and they already have a relationship with the sender. The exact interpretation of “similar” in this context is not clear.

The European debate did not give any answer to this question, nor did the debate before the French Parliament. Could a supermarket, for example, only e-mail its online customers about special offers on cakes if it is what they have bought before or should it be able to direct-market its whole range of food and other products or services? This question is very important too.

#### **2. In France**

France is currently completing the implementation of Directive 2002/58/EC into French national law. The bill of transposition of the Directive, passed by the *Assemblée Nationale* on 26 February 2003 and by the Senate on 25 June 2003, raises several issues and the new provisions may be difficult in practice to implement. It will be discussed—and certainly adopted—by the French *Assemblée Nationale* in October/November 2003. The discussion over the bill resulted in the following:

##### **a. Setting up a transitory system**

Until the effective date of the law, 31 October 2003, client or prospect-related information may be used to ask clients or prospects whether they consent to further direct marketing operations. After this date, if the consent is not obtained, all client or prospect related information, even fairly collected, will be lost, since there will be an assumption that individuals refused to

receive direct marketing operation. The economic consequences will be unprecedented and this transitory system might create the biggest spam ever in France from companies willing to obtain consent of their existing prospects/clients.

#### **b. Defining consent**

Consent is defined in the terms set by article 2 of Directive 95/46/EC. The introduction of that definition shows the importance of consent in marketing operations and outlines the fact that consent cannot be buried in an acceptance of the general terms of a proposed service. In that respect, the CNIL recommends that the user's consent be expressed by checking a box, as suggested in the introduction of Directive 2002/58/EC. Inserting a pre-checked box or a clause in terms and conditions is against the spirit of the text and against the principle of fair collection of data, in that such a consent is not explicit or freely given.

#### **c. Determining the scope of the exemption from the prior consent principle**

The exemption, as defined in the Directive, only applies if the communications concern "products or services similar" to those supplied by the same business entity that collected the electronic address of the recipient. The concept of "products or services similar" can lead to different interpretations. The CNIL has recommended a strict interpretation of the scope of exemption. For instance, the operation consisting of buying a book online authorizes the seller to prospect the buyer for a record (concept of cultural product), but it does not authorize the seller to prospect the buyer for a trip, even if it is a service online.

#### **d. Applying the prior consent principle only to individuals or also to companies**

The French legislature chose to apply the prior consent principle to both individuals and companies for marketing operations carried out by fax. Regarding e-mail marketing, the French legislature chose to distinguish between companies that are not registered in the RCS (French companies registry), which fall within the scope of the prior consent principle, and others, which remain under the previous system, the "opt-out" system.

This choice leads to the issue of distinguishing between electronic addresses of individuals and electronic addresses of registered companies, which is impossible most of the time. For instance, where the electronic addresses of employees clearly indicates their company's name, is this e-mail address an individual or a professional address? Thus Dupont@wanadoo.fr: How does one qualify that address?

### **D. The Current Spam Phenomenon in France**

#### **1. Cases in France**

There are very few complaints concerning cases of spamming in France.

- The first condemnation of a spammer in France dates from 28 February 2001. The Tribunal de Grande Instance of Rochefort-sur-Mer condemned a subscriber of France Télécom Interactive (FTI) who sent massively commercial documents on discussion forums. FTI had cut off the Internet connection of the spammer. The Tribunal adopted a contractual approach to the issue and referred to the access providers' general terms and conditions of use. It admitted that sending unsolicited e-mails was a breach of "netiquette" (informal code of conduct on the Internet) and considered as justified the breach by FTI of the Internet access contract. The Tribunal ruled, under the provisions of articles 1135 and 1184 of the Civil Code, that netiquette has a legal value, since it was mentioned in the FTI contract to the effect that users are to comply with the rules of netiquette.
- On 15 January 2002, the Tribunal de Grande Instance of Paris rendered a summary judgment ruling that Internet access providers are entitled to stop their clients' access to the Internet if they practice spam. Two Internet access providers, Liberty Surf and Free.fr, have cut off the Internet connection of some of their subscribers who repeatedly flooded their networks with unsolicited e-mail messages. The subscriber/spammer sued the Internet providers for damages to his business. The Tribunal dismissed the plaintiff's request and condemned him because he seriously disrupted the network and was a nuisance to Internet users, even after having been repeatedly asked to stop and having been informed that his behavior would cause the blocking of his Internet access. The Tribunal said, "Spamming is considered in the Internet community as an unfair practice, that is contrary to codes of good behavior."

#### **2. These Cases Lead to Two Observations**

Paradoxically, although spamming infringes French data protection rules, since it infringes the principles of fair and legitimate collection of personal data and right of access to/cancellation of personal data, no legal actions have been brought in France under the provisions of the Law of 6 January 1978. In both cases mentioned above, the courts adopted a contractual approach to the issue.

The low volume of litigation may be explained by the facts that not all the Directives have yet been imple-

mented into French national law and that spam victims tend to turn mostly to their Internet access providers. Also, the difficulty of identifying senders of spam explains the scarcity of complaints and shows the limits of a local legal response to the problem of spamming.

### **3. The CNIL's Action**

In reaction to this situation, in July 2002, the CNIL announced the opening of an electronic mailbox, "spam box" (spam@cnil.fr), which invited Internet users to transfer unsolicited e-mails which they received and considered as spam.

This initiative consisted of analyzing messages received every day in order to determine the extent of spamming in France. It is the first time that figures related to spamming in France were published by a public authority. More than 320,000 messages were received within two months, and allowed a precise picture of the phenomenon of spamming in France to be drawn.

The e-mails received have been classified in accordance with their geographic origin. The result is that 84.8% of spam transferred to the CNIL by French users are drawn up in the English language, 8% are of Asian origin, and 7% are drawn up in French. The proportion of messages in other languages was negligible. Each category of messages has then been classified in accordance with its content. It appeared that individuals, as opposed to companies, are the main targets of spam: 85% of spam propose products or services that would be of interest to individuals, whereas 15% of spam were aimed at companies. And it appears that the practice of spamming in France is mainly the fact of small companies, since the cost of solicitations is undergone by the persons marketed.

The study of the messages received has allowed identification of a certain number of companies that are the source of massive and repeated sending of spam. The CNIL referred five companies to the Public Prosecutor.

By this initiative, the CNIL wants to show to spammers that they cannot infringe the law with total impunity.

### **V. An International Issue**

The international dimension of spam is reflected in the broad scope of the new Directive: spam is banned as of October 2003 on all public EU networks, regardless of where the spam originates. But as the operation "spam box," held by the CNIL, suggested, the majority of spam comes from outside the European Union.

International co-operation both within the European Union and with third countries, especially the

United States, will be essential for any system to be sufficiently effective and to facilitate a more efficient handling of litigation. It is also important to check that in third countries, especially in the United States, there is general or specific legislation in place against spam in order to allow the beginning of any international cooperation.

#### **A. What Is the Situation in the United States?**

The United States is now seriously working on legislation to combat spam and is considering spam as one of the major challenges for the Internet. Since 2000, thirty-five U.S. states have adopted specific legislation prohibiting spam, the last one being Virginia, which, since 2 May 2003, provides criminal penalties for fraudulent, high-volume spammers and outlaws practices like infringing the return address line of an e-mail message or hacking a computer to send spam.

A new report by the Federal Trade Commission (which up to now can only sue for deceptive advertising) found that two-thirds of spam is sent with either false return addresses or a misleading subject line.

Recently, America On Line (AOL) has won a U.S. court judgment for nearly \$7 million in damages against a group of spammers who bombarded AOL members with spam. The awarded damages was the largest ever from one of its lawsuits against spammers. AOL has filed twenty such lawsuits over the years. One of the defendants in the latest case was CN Productions, a company AOL successfully sued in 1999. In the complaint that led to the most recent award, AOL said CN and its associates transmitted more than one billion junk messages, accounting for a quarter of complaints AOL received about spam promoting adult sites.

Microsoft has also launched seventeen actions against spammers (fifteen were located in the U.S.) in June 2003, indicating that 2.5 billion spam were entering every day into Hotmail accounts, of 6.5 billion messages entering every day into Hotmail inboxes.

Unfortunately, even though AOL, Microsoft and other large ISPs routinely take spammers to court and win large judgments, they do so usually because defendants fail to show up. Consequently they are often unable to collect damages, and judgments against specific spammers has had little effect in stopping the flood of junk e-mail.

#### **B. The Urgent Need for an International Legal Consensus Against Spam**

Everybody agrees that spam will not decrease by itself, but only after sanctions against spammers become effective. However, spam is an international problem, and this common view is not enough to solve the problem.

## 1. Without Domestic Laws, No International Discussion

The first step for an international co-operation between U.S. and EU Member States would be that U.S. and EU have both adopted at least domestic legislation against spam. Even though cultural approaches between the U.S. and the EU are different, the goal of anti-spam legislation at the federal or regional level will be in any case to restrain special unsolicited e-mailing and sending of e-mail with hidden, false or invalid addresses. There would be a chance to base international discussions on existing national legislations.

## 2. Without Sharing of Information, No International Co-Operation

The second step would be that both the U.S. and the EU public bodies in charge of spam prosecution be able to share information. However, the U.S. Federal Trade Commission is not allowed by U.S. law to share information with foreign public authorities, and has only power in the field of deceptive advertising and, therefore, can only be effective regarding the content of commercial communication but not on real spam practices (hiding the identity of the sender, collecting or sharing information between companies without Internet users' awareness, etc.).

But for "spam wars," as for any other worldwide phenomenon, international co-operation is the key to the solution of the problem.

## 3. Without Advertisers, Fewer Spammers

Complaining about the difficulty of identifying spammers is not enough. Most spammers make profits by advertising products and services to millions of people, even though the answering rate is very low. Therefore, why not sue the advertisers who finance spam practices? Spam almost always mention a web site which offers products or services. Cutting spam industry financing would probably significantly reduce spam volume inasmuch as advertisers should be legally responsible for their communication's distribution.

## 4. Without Comprehensive Answers, No Efficiency

It is essential not to forget that combating spam implies fighting on many fronts and not only on the

legal front. Technical actions, awareness, and education actions are also essential.

## Endnotes

1. "Spam": This expression comes from a Monty Python sketch in which the word "spam," the contraction of "spice ham," an English brand of pork meat, is constantly repeated in order to push the listeners into becoming consumers.
2. Schwartz & Garfinkel, *Stopping Spam—Stamping out Unwanted E-mail & News Posting*, O'Reilly (Oct. 1998).
3. Hesseldahl, *Cutting Spam Down to Size*, Forbes.com (4 June 2003).
4. The CNIL is the French data protection authority, an independent administrative authority founded by the French data protection law n° 78-17 dated 6 January 1978.
5. Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, *Official Journal L 281*, 23/11/1995 P. 0031 – 0050.
6. See <http://www.cnil.fr/frame.htm?http://www.cnil.fr/textes/ttext.htm>.
7. Keep in mind, however, that the points of this case did not involve spamming.
8. Article 2(h).
9. Article 14: "A data subject may object, free of charge, to the processing for commercial purposes of personal data relating to him or to the disclosure of his personal data to third parties, of which he must be informed in advance."
10. Directive 97/66/EC of the European Parliament and of the Council of 15 December 1997 concerning the processing of personal data and the protection of privacy in the telecommunications sector.
11. Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts.
12. Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market.
13. Article 5.
14. Directive 2002/58/EC of 12 July 2002 concerning the processing of personal data and protection of privacy in the electronic communications sector.

**Mr. Renault is a senior associate in the Media Entertainment Law section of the law firm of Gide Loyrette Nouel in Paris.**

# Making Sense of Four Transatlantic Estate Tax Treaties: US-Netherlands, US-Germany, US-France and US-UK

By Michael W. Galligan

## I. Introduction

The purpose of this paper is to present a summary of the principal rules for the allocation of estate taxes and the avoidance of double taxation under four of the most important estate tax treaties to which the United States is a party, namely, the treaties with the United Kingdom, France, the Netherlands and Germany. Each of these treaties follows the “modern” approach to estate tax treaties, where the determination of a decedent’s domicile (rather than the situs of the decedent’s property) is the principal criterion for determining the allocation of taxes and the distribution of related tax credits.

The next part of this paper describes the rules for determining domicile incorporated by these treaties, together with a description of the relevant variations contained in specific treaties. The third part of this paper describes the treatment under ten scenarios of the allocation of taxes and credits, again with a description of the relevant variations contained in specific treaties. The last part of the paper reviews certain provisions regarding the treatment of property passing to surviving spouses and charities.

## II. Domicile

Each reference to domicile in a treaty is a reference to domicile as determined under the relevant treaty. While treaty domicile is related to the determination of domicile or residence under the law of the taxing country, it is not necessarily the same.

### A. Generally

As a preliminary matter, a person is domiciled in a treaty country if that country considers the person domiciled under its internal transfer tax law.<sup>1</sup> There is, however, an exception: Under the US-UK Treaty, a US citizen is considered domiciled in the United States, as a preliminary matter, only if the US citizen was domiciled in the United States at some point during the three preceding years. This limitation does not preclude the US from worldwide taxation on the basis of citizenship even if the person did not meet this test.<sup>2</sup>

### B. Citizenship of One Country; Domicile in Another

European countries do not generally tax on the basis of citizenship. Nonetheless, in the case of a person who is a citizen of one country but domiciled in the

other under that other country’s laws, citizenship can be relevant to treaty domicile.

For example, under the US-UK Treaty, a US citizen who is not a UK citizen and who was resident for income tax purposes in the United Kingdom for fewer than seven of the preceding ten years (without regard to the issue of whether the person had a home there) is treated as a US treaty domiciliary. The same rule applies to a UK citizen living in the United States, except that the availability of a home in the US is not excluded from consideration in determining whether the person was a US income tax resident.<sup>3</sup>

### C. If Concurrent Domicile in Each Country

If each country considers a person its domiciliary, the following timing rules also apply:

- *US-Germany*: If the person is a citizen of one country only, the person cannot be considered a domiciliary of the other country until the person has been a domiciliary there for ten years.<sup>4</sup>
- *US-France*: If the person is a citizen of one country only, the other country cannot tax on the basis of domicile if the person was present for fewer than five out of seven years and maintained the intent to retain domicile in the citizenship country. The intent requirement is disregarded if the person was in the other country for employment reasons or was the spouse or other dependent of such a person. The period is extended to fewer than seven out of ten years if the person was in the other country by renewal of an assignment of employment or as a spouse or dependent of such a person.<sup>5</sup>
- *US-Netherlands*: If the person is a citizen of one country only, then the other country cannot tax on the basis of domicile if the person was present for fewer than seven out of ten years and the person was in the other country for professional, educational, tourism or similar purposes and did not have a “clear intention to remain indefinitely” in the other country. This rule applies to spouses and dependents also.<sup>6</sup>

### D. Tie Breakers

Each Treaty provides a set of “tie-breaker rules” in the event each country considers a person its domiciliary. The criteria are, in order:

- Where did the person have a permanent home?
- Where was the person's center of vital interests or personal relations?
- Where did the person have a habitual abode?
- In which country was the person a citizen?

There is, however, an exception to these tie-breaker rules. Under the US-Netherlands Treaty, the first criterion is "where did the person have a permanent home *for five years*," and the criterion regarding habitual abode is omitted. This Treaty uses closeness of personal relations for the second criterion, but this may be seen as equivalent to the center of vital interests, especially in light of the US-French Treaty, which treats them as the same.<sup>8</sup>

### III. Ten Scenarios Regarding the Allocation of Taxes and Tax Credits

#### A. European National who is European Country Domiciliary ("ENED") or United States Citizen who is European Country Domiciliary ("USCED") owns real estate in the United States.

US collects its estate tax on the US real property of ENED or USCED. The European Country (either the United Kingdom, France, the Netherlands or Germany—"EC") also imposes estate tax on the US real property, but gives ENED's or USCED's heirs a credit against the US tax.<sup>9</sup>

In addition, the ENED's or USCED's "business property of a permanent establishment and assets pertaining to a fixed base used for professional services" located in the United States would be taxed in the same manner.<sup>10</sup>

The US will also apply a pro-rata share of the unified credit available to US citizens and domiciliaries to the tax on the US property of a German domiciliary ("GD") who is not a US citizen.<sup>11</sup>

One exception of the foregoing is that France does not tax US real property or US business establishment property of a French domiciliary ("FD").<sup>12</sup> In addition, the United States does not tax US real property or business establishment property of a Netherlands national if the value is less than \$30,000; nor can the tax exceed the lesser of fifty percent of value in excess of \$30,000 or the amount of the tax determined in accordance with the Treaty after applying exemptions under US law.<sup>13</sup>

#### B. United States Domiciliary Citizen ("USCD") or European National who is United States Domiciliary ("ENUSD") owns real property in the EC.

The EC collects its tax on the EC real property of USCD. The US imposes its tax on the EC property as

well, but gives USCD's or ENUSD's estate a credit against US tax for the EC tax on the EC real property.<sup>14</sup>

In addition, the USCD's or the ENUSD's "business property of a permanent establishment and assets pertaining to a fixed base used for professional services" located in the EC would be taxed in the same manner.<sup>15</sup>

The Netherlands does not tax Netherlands real property or business establishment property of a US domiciliary if the value is less than \$30,000; nor can the tax exceed the lesser of fifty percent of value in excess of \$30,000 or the amount of the tax determined in accordance with the Treaty after applying exemptions under Netherlands law.<sup>16</sup>

#### C. ENED owns collection of paintings for personal use in the United States.

The US collects no tax on the US painting collection of the ENED. The EC imposes its tax on the collection.<sup>17</sup>

The same rule would generally apply to other forms of tangible property in the United States not connected with a business establishment owned by the ENED. In addition, the United States does not tax ships and aircraft engaged in international traffic belonging to the GD if the ships and aircraft are part of the GD's enterprise (presumably even if the enterprise constitutes a US business establishment).<sup>18</sup>

An exception to the foregoing is that, in the case of an FD, FD's tangible property (other than currency) located in US would be subject to US tax (except for property of certain persons, as discussed in Part II.C., who held tangible property for personal use).<sup>19</sup> Also, the FD's ships and aircraft operated in international traffic that are registered in the United States or that most frequently use the harbors and airports of the United States would be subject to US tax.<sup>20</sup> Under these circumstances, France would not tax FD's US tangible property.<sup>21</sup>

#### D. USCD owns collection of paintings for personal use in European Country.

The EC collects no tax on the EC painting collection owned by the USCD. The US imposes its tax on the collection.<sup>22</sup>

The same rule would generally apply to other forms of tangible property in the EC not connected with a business establishment owned by the USCD. In addition, Germany does not tax ships and aircraft engaged in international traffic belonging to the USCD if the ships and aircraft are part of the USCD's enterprise (presumably even if the enterprise constitutes a German business establishment).<sup>23</sup>

One exception is that, in the case of a USCD owned tangible property in France, such property (other



than currency) would be subject to French tax (except for property of certain persons, as discussed in Part II.C. above, who held tangible property for personal use).<sup>24</sup> Also, the USCD's ships and aircraft operated in international traffic that are registered in France or that most frequently use the harbors and airports of France would be subject to French tax.<sup>25</sup> Under these circumstances, the US would give a credit for the French tax.<sup>26</sup>

#### **E. An ENUSD owns collection of paintings for personal use in the EC.**

The US imposes its tax on the collection owned by the ENUSD. The EC is authorized to tax the collection of an EN on the basis of EN's nationality, although no EC currently does so on this basis alone. If it did, the EC should give credit against its tax for the US tax.<sup>27</sup>

The same rule would generally apply to other forms of tangible property in the EC not connected with a business establishment owned by the ENUSD. In addition, Germany does not tax ships and aircraft engaged in international traffic belonging to the USCD if the ships and aircraft are part of the USCD's enterprise (presumably even if the enterprise constitutes a German business establishment).<sup>28</sup>

Among those exceptions are the following.

- In the case of an ENUSD owning tangible property in France, such property (other than currency) would be subject to French tax (except for property of certain persons, as discussed in Part II.C., who held tangible property for personal use).<sup>29</sup> Also, the ENUSD's ships and aircraft operated in international traffic that are registered in France or that most frequently use the harbors and airports of France would be subject to French tax.<sup>30</sup> Under these circumstances, the US would give a credit for the French tax.<sup>31</sup>
- Germany is effectively not permitted to tax on the basis of citizenship alone, although it may tax a German beneficiary receiving tangible property from a US citizen or domiciliary.<sup>32</sup>
- In the case of a US domiciliary who is a Netherlands national, the Netherlands must give full credit for US tax only if the Netherlands national-US domiciliary was a US domiciliary for seven out of last ten years.<sup>33</sup> Otherwise, each of the Netherlands and the US gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to total of both taxes.<sup>34</sup>

#### **F. USCED owns collection of paintings for personal use in the United States.**

The US and the EC each impose its respective tax on the US collection of the USCED. The US gives a credit for the EC tax against the US tax.<sup>35</sup>

The same rule would generally apply to other forms of tangible property in the EC not connected with a business establishment owned by the USCED.

Exceptions to this rule include the following:

- France would not tax the US tangible property of a USCED.<sup>36</sup>
- In the case of a USCND who is not a Netherlands citizen, the US gives full credit for the Netherlands tax only if USCND was the Netherlands domiciliary for seven out of last ten years.<sup>37</sup> Otherwise, each of the US and the Netherlands gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to the total of both taxes.<sup>38</sup>

#### **G. ENED owns stock in US companies.**

US collects no tax on the US stock of the ENED. The EC imposes its tax on the stock.<sup>39</sup>

The same rule would generally apply to other forms of intangible property in the United States owned by the ENED. However, interests owned by the GD in partnerships holding US real property and business establishment property may be taxed by the United States, and Germany would give a credit against the US tax.<sup>40</sup>

#### **H. USCD owns stock in EC companies.**

The EC collects no tax on the EC stock. The US imposes its tax on the EC stock owned by the USCD.<sup>41</sup>

France does not tax US real property or US business establishment property.<sup>42</sup> The same rule would generally apply to other forms of intangible property in the European country owned by the USCD.

One exception is that interests owned by the USCD in partnerships holding German real property and business establishment property may be taxed by Germany, and the United States would give a credit against the German tax.<sup>43</sup>

#### **I. ENUSD owns stock in EC companies.**

US imposes its tax on the EC stock owned by the ENUSD. The EC is authorized to tax the stock. If it did, the EC should give credit against its tax for the US tax.<sup>44</sup> The same rule would generally apply to other forms of intangible property in the European Country owned by ENUSD.

The exceptions to the above rule include the following:

- While France is not precluded from taxing on the basis of French nationality, there is no effective credit under the US-France Treaty if it did.<sup>45</sup>
- Germany is effectively not permitted to tax on the basis of citizenship alone, although it may tax a German beneficiary receiving property from a US citizen or domiciliary.<sup>46</sup> Also, interests owned by the ENUSD in partnerships holding German real property and business establishment property may be taxed by Germany, and the United States would give a credit against the German tax.<sup>47</sup>
- In the case of a US domiciliary who is a Netherlands national, the Netherlands must give full credit for the US tax only if the USEN was a US domiciliary for seven out of the last ten years.<sup>48</sup> Otherwise, each of the Netherlands and the US gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to the total of both taxes.<sup>49</sup>

#### J. USCED owns stock in US companies.

The US and the EC each impose its respective tax on the US stock. The US gives a credit for the EC tax against the US tax.<sup>50</sup> The same rule would generally apply to other forms of intangible property in the United States owned by USCED.

The exceptions to the above rule include the following:

- Interests owned by the USCED in partnerships holding US real property and business establishment property may be taxed by the United States, and Germany would give a credit against the US tax.<sup>51</sup>
- In the case of a USCED who is not a Netherlands citizen, US gives full credit for the Netherlands tax only if USCED was a Netherlands domiciliary for seven out of the last ten years.<sup>52</sup> Otherwise, each of the US and the Netherlands gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to the total of both taxes.<sup>53</sup>

### IV. Other Topics

#### A. Charitable Deductions

There are no special rules in the US-UK or US-Netherlands Treaties.

In the US-Germany treaty, there is a reciprocal charitable deduction for donor country persons for transfers to charitable organizations and public bodies in the other country if the transfer would be exempt from tax in the donee country and the transfer would be exempt in the donor country if the gift were made to a similar charity or public body in the donor country.<sup>54</sup>

In the US-France treaty, essentially the same rule as with Germany applies, but the charitable organization must receive a substantial part of its support from contributions from the public or governmental funds.<sup>55</sup>

#### B. Marital Deductions

Under the US-UK treaty, in the case of property passing to the spouse of a decedent who is a US citizen or domiciliary, the UK will allow a fifty percent marital deduction, even if the spouse is not domiciled in the UK.<sup>56</sup>

Under the US-France treaty, property (other than community property) acquired during the marriage by a US citizen or domiciliary will be treated for French tax purposes as community property (in the absence of a contrary election).<sup>57</sup>

Under the US-Netherlands treaty, real property and business/professional establishment property (other than community property) passing to the surviving spouse from a US citizen or domiciliary will be included in the estate for purposes of the Netherlands death duty only to the extent its value exceeds fifty percent of all property taxable by the Netherlands. The value of the property is determined after taking into account allowable deductions but before taking into account the treaty exclusion of property with a value under \$30,000.<sup>58</sup>

Under the US-Germany treaty, real property, business/professional establishment property (other than community property), and certain ships and aircraft passing to a surviving spouse from a citizen or domiciliary of either country that may be taxed by a country because the property is located there may only be taxed to the extent its value exceeds fifty percent of all property taxable by that country.<sup>59</sup> There is also available a US marital deduction limited to the US applicable exclusion for property passing from a US or German domiciliary to a US or German surviving spouse, if an election not to use QDOT to secure a deduction is made.<sup>60</sup>

#### C. US State Death Taxes

According to the US-Germany Treaty, certain credits allowed by Germany may also include "taxes levied by political subdivisions of the United States."<sup>61</sup>

## Endnotes

The references to "UK," "FR," "NETH," and "GER" followed by a numbered reference refer to a particular section of the U.S. estate tax treaty with the United Kingdom, France, the Netherlands, and the Federal Republic of Germany, respectively.

1. UK4(1), FR4(1), NETH4(1), GER4(1).
2. UK4(1)(a), 5(1)(b).
3. UK4(2)&(3).
4. GER4(3).
5. FR4(3).
6. NETH4(2).
7. UK4(4); FR4(2); NETH4(3); GER4(2).
8. NETH4(3). *See also* FR4(2)(b).
9. UK6 and 9(2)(a), FR5 and 12(2)(a), NETH6 and 11(1); GER5 and 11(3)(a).
10. UK7; FR6; NETH7; GER6. The Netherlands Treaty clearly states that the fact that a decedent controlled a corporation that engaged in business in a country does not determine that the decedent had a permanent establishment in the country for estate or inheritance tax purposes. NETH7(7). The United Kingdom Treaty provides that the fact that a company residing in one country controls (or is controlled by) a company resident in the other country or doing business in the other country does not constitute either company a permanent establishment of the other. UK7(2)(g). The German Treaty has an analogous provision. GER6(2)(f). Finally, the French Treaty provides that the fact that an enterprise controlled a corporation that engaged in industrial or commercial activity in a country should not be taken into account in determining whether the enterprise had a permanent establishment in that country.
11. GER10(5).
12. FR12(2)(a).
13. NETH10(2).
14. UK6 and 9(1)(a); FR5 and 12(2)(b); NETH6 and 11(1); GER5 and 11(2)(a).
15. UK7; FR6; NETH7; GER6.
16. NETH10(2).
17. UK5(1)(a) (excludes from US tax all property except for US real property and US business establishment property); FR8 (excludes from US tax all property except for US real property, US business establishment property and certain US tangible property (including certain ships and aircraft)); NETH8 (excludes from Netherlands tax all property except for US real property and US business establishment property); GER9 (excludes from US tax all property except for US real property, US business establishment property, and interests in partnerships owning any of such US property).
18. GER7.
19. FR7(1)&(2).
20. FR7(3).
21. FR12(2)(a).
22. UK5(1)(a) (excludes from UK tax all property except for UK real property and UK business establishment property); FR8 (excludes from French tax all property except for French real property, French business establishment property and certain French tangible property (including certain ships and aircraft)); NETH8 (excludes from Netherlands tax all property except for Netherlands real property and Netherlands business establishment property); GER9 (excludes from German tax all property except for German real property, German business establishment property, certain German-connected ships and aircraft, and interests in partnerships owning any of such German property).
23. GER7.
24. FR7(1)&(2).
25. FR7(3).
26. FR12(2)(b).
27. UK5(1)(b) and 9(2); FR8 and 12(2)(a); NETH9 and 11(2).
28. GER7.
29. FR7(1)&(2).
30. FR7(3).
31. FR12(2)(b).
32. GER 4(1), 11(1)(b).
33. NETH11(2)(a).
34. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.
35. UK5(1)(b) and 9(1)(b); FR8 and 12(3); NETH9 and 11(2)(c), *but see* 11(2)(a) and (c); GER11(1), 11(2)(b).
36. FR12(2)(a).
37. NETH11(2)(a).
38. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.
39. UK5(1)(a) (excludes from US tax all property except for US real property and US business establishment property); FR8 (excludes from US tax all property except for US real property, US business establishment property and certain US tangible property (including certain ships and aircraft)); NETH8 (excludes from US tax all property except for US real property and US business establishment property); GER9 (excludes from US tax all property except for US real property, US business establishment property, certain US-connected ships and aircraft, and interests in partnerships owning any of such US property).
40. GER8 and 11(3)(a).
41. UK5(1)(a) (excludes from UK tax all property except for UK real property and UK business establishment property); FR8 (excludes from French tax all property except for French real property, French business establishment property and certain French tangible property (including certain ships and aircraft)); NETH8 (excludes from Netherlands tax all property except for Netherlands real property and Netherlands business establishment property); GER9 (excludes from German tax all property except for German real property, German business establishment property, certain German-connected ships and aircraft, and interests in partnerships owning any of such German property).
42. FR12(2)(a).
43. GER8 and 11(2)(a).

44. UK5(1)(b) and 6; FR5, 8 and 12(2)(a); NETH6, 9, 11(1)&(2); GER5 and 11(2)(a).
45. FR12(2)(a).
46. GER 4(1), 11(1).
47. GER8 and 11(2)(a).
48. NETH11(2)(a).
49. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.
50. UK5(1)(b) and 9(1)(b); FR8 and 12(3); NETH9 and 11(2)(c), *but see* 11(2)(a) and (c); GER11(1), 11(2)(b).
51. GER8 and 11(3)(a).
52. NETH11(2)(a).
53. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty

percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.

54. *See* GER10(2).
55. FR10(2).
56. UK8(3).
57. FR11.
58. NETH10(1).
59. GER10(4).
60. GER10(6).
61. GER11(4).

**Mr. Galligan is a partner in the trusts and estates department of the New York City law firm of Phillips Nizer LLP.**



**NEW YORK STATE BAR ASSOCIATION  
INTERNATIONAL LAW AND PRACTICE SECTION**

**SAVE THE DATE**



**FALL MEETING 2004  
SANTIAGO de CHILE  
November 10 - 14, 2004  
The Ritz-Carlton Hotel**

# The Impact of EU Law on Cross-Border Taxation Issues Relating to Limitation on Benefits Provisions in Income Tax Treaties Between EC Member Countries and the United States

By James R. Shorter, Jr.

## I. Introduction and Background

Many recent bilateral tax treaties entered into by the United States include so-called "Limitation on Benefits" ("LOB") clauses intended to prevent "treaty shopping" by third country nationals. In connection with an examination of the impact of EU law on cross-border taxation, a discussion of these treaty provisions seems appropriate, because such provisions, as described below, could in effect be deemed to discriminate against nationals of EC Member Countries other than the direct treaty partner of the United States under the bilateral tax treaty. Although the European Court of Justice ("ECJ") has not specifically addressed such LOB provisions, its recent decision in the so-called "*Open Skies* case," discussed below, suggests that such LOB provisions might violate the non-discrimination requirements under the EC treaty and relevant regulations.

This paper will discuss (i) the background and nature of the LOB provision, as set forth in the 1996 US Model Income Tax Treaty; (ii) the *Open Skies* case, and the two tax cases cited therein; and (iii) the LOB provision in a representative US bilateral tax treaty.

## II. Limitation on Benefits Provisions in the US Model Treaty

### A. Generally

In connection with its negotiation of income tax treaties, the US Treasury Department has prepared a US Model Income Tax Convention, the most recent of which was issued on 20 September 1996 ("US Model Treaty").<sup>1</sup> In connection with the issuance of this model, the Treasury Department prepared a "Technical Explanation,"<sup>2</sup> which, among other things, explains the purposes for publishing the US Model Treaty. The Technical Explanation notes that the Model is not intended to represent an ideal US Income Tax Treaty, but rather to facilitate negotiations by assisting the negotiators to identify differences between income tax policies of the two countries.<sup>3</sup> Further, because it is not intended to be proposed to a treaty partner without variation, it should not be assumed that a departure from the model text in an actual treaty represents a departure from United States treaty policy.<sup>4</sup> In this context, it is worthwhile to consider the Technical Explanation's description of Article 22 of the US Model Treaty, relating to Limitation on Benefits.

### B. Purpose of Limitation on Benefits Provisions

Because the United States views an income tax treaty as a means of providing benefits to residents of the United States and the other party to the treaty (the "Contracting States"), it is necessary to determine who should be treated as a resident of each such country for the purpose of obtaining treaty benefits. The United States strongly adheres to the view that tax treaties should contain provisions to prevent misuse of the treaties by residents of third countries.<sup>5</sup> So-called "treaty shopping" is the use by such third-country residents of legal entities established in a Contracting State for the purpose of obtaining the benefits of a tax treaty, which might not be provided directly by treaties, if any, entered into between their country and the United States. However, such third-country residents would not be considered to be engaged in treaty shopping if there were substantial reasons for establishing the structure that were unrelated to obtaining such treaty benefits.<sup>6</sup> Because it is difficult to administer taxes based upon a taxpayer's intent, the LOB provision sets forth a series of objective tests, which, if satisfied, indicate that the third party resident has a real business purpose for the structure, or a sufficiently strong nexus to the other Contracting State to warrant the granting of benefits under the Treaty.<sup>7</sup>

The LOB Provision from the US Model Treaty is attached as Exhibit A. The Technical Explanation notes that Article 22(3) of the LOB Provision provides an "active trade or business test," which is based upon the assumption that a substantial operation would not be established by a third-country resident simply to avail itself of the benefits of the Treaty. Thus, in such a case it is presumed that the third-country resident investor had a valid business purpose for such investment in an entity in the other Contracting State. Further, it is considered unlikely that such an investor would incur the expense of establishing such a substantial trade or business simply to obtain the benefits of the Treaty.<sup>8</sup>

The LOB article provides that treaty benefits based upon residence are only available to the extent provided in the LOB Provision. Generally, these residence-based treaty benefits include relief from withholding on dividends, interest and royalties, as well as other benefits that relate to source-based taxation, including the business profits and personal services articles of the

treaty, as well as the “other income” provision and the provisions relating to Relief from Double Taxation and Non-Discrimination. Provisions which do not require residence for purposes of enjoying a benefit are not subject to the LOB Provision.<sup>9</sup> Generally, in addition to residents engaged in an active trade or business who qualify under Article 22(3) described above, Article 22(2) provides that individuals and “qualified governmental entities” are entitled to treaty benefits without further qualification requirements.<sup>10</sup>

In the case of a corporation, Article 22(2)(c) applies to two categories of corporations: publicly traded corporations and subsidiaries of publicly traded corporations. Generally, in the case of publicly traded corporations, a company is entitled to the benefits of the Treaty if all of the shares in the class or classes of shares that represent more than fifty percent of the voting power and value of the company are regularly traded on a “recognized stock exchange” located either in the US or the other Contracting State. The term “regularly traded” is not defined in the US Model Treaty, and, based upon the “General Definitions” Provision of the Treaty, is defined by reference to the domestic tax laws of the country from which treaty benefits are sought (i.e., the source country). In the case of the United States, under Treas. Reg. § 1.884-5(d)(4)(i)(B) a class of shares is considered “regularly traded” if trades in such class of shares are made in more than *de minimis* quantities on at least sixty days during the taxable year, and the aggregate number of shares in such class that is traded during the year is at least ten percent of the average number of outstanding shares during the year.<sup>11</sup> Such regular trading requirement can be satisfied by trading on the recognized exchanges located in either country, and by aggregating such trading.<sup>12</sup>

In the case of a subsidiary of a publicly traded corporation, a company is entitled to the benefits of the US Model Treaty if fifty percent or more of each class of its shares is directly or indirectly owned by publicly traded corporations that satisfy the requirements described in the foregoing paragraph. Although indirect ownership is permitted, any intermediate owners in the chain of ownership must themselves be entitled to treaty benefits under the foregoing provision.<sup>13</sup>

Article 22(2)(d) and (e) apply, respectively, to tax-exempt organizations and pension funds.

If the resident of the other Contracting State does not otherwise qualify under one of the provisions mentioned above, it may qualify for benefits under the US Model Treaty pursuant to Article 22(2)(f), which requires satisfaction of (i) a so-called ownership test and (ii) a base erosion test. Under the ownership test a company qualifies if it is at least fifty percent owned by persons which qualify under Article 22(2)(a) through (e). Such ownership may be direct or indirect (provided

the persons in the “chain” of such indirect ownership are persons who are described in those provisions); the fifty-percent ownership requirement applies to each class of beneficial interest in such person; and such test must be met on at least half of the days of the company’s taxable year.<sup>14</sup> The base erosion test requires that less than fifty percent of the company’s gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are nonresidents of either Contracting State (unless the income is attributable to a permanent establishment located in either country) in the form of payments that are deductible for income tax purposes in the entity’s country of residence. Deductions, such as depreciation and amortization deductions, that are not “payments” are disregarded for this purpose.<sup>15</sup>

As noted above, under Article 22(3) a resident of a Contracting State that is not generally entitled to benefits of the Convention under the foregoing provisions of Article 22(2) may receive treaty benefits with respect to certain items of income that are connected with an active trade or business. The US Model Treaty provides a three-part test, and all three conditions must be satisfied to establish entitlement to the benefits of the treaty with respect to a particular item of income:

- The resident must be engaged in the active conduct of a trade or business in the Contracting State of its residence.
- The income derived from the other Contracting State must be derived in connection with, or be incidental to, that trade or business.
- The trade or business must be substantial in relation to its activity in the other Contracting State that generated the item of income.<sup>16</sup>

It should be noted that Article 22(3)(b) provides that the business of making or managing investments, when part of banking, insurance or securities activities conducted by a bank, insurance company, or registered securities dealer, will be considered to be a trade or business, but such activities conducted by any other person will not be so treated. Since a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company is not considered engaged in an active trade or business for these purposes.<sup>17</sup> Article 22(3)(c) provides that whether the trade or business of the income recipient is “substantial” is determined based on all the facts and circumstances. This provision provides a safe harbor which applies three ratios (relating to asset value, gross income, and payroll expense) that compare the size of the recipient’s activities to those conducted in the other Contracting State.<sup>18</sup>

Finally, Article 22(4) provides that a resident that is not otherwise entitled to the benefits of the treaty may

be granted benefits if the competent authority of the Contracting State from which benefits are claimed so determines.

Under the LOB provision of the US Model Treaty, the United States could deny benefits to a company or national of one of the other EC Member Countries, which are not a party to the particular treaty, in the case of an entity established in the treaty country by such company or national which does not qualify under the foregoing provisions. As discussed below, based upon the *Open Skies* case, such an LOB provision in a particular treaty could be treated as violating the non-discrimination principle of the EC Treaty and related Council regulations.

### III. EC Non-Discrimination and National Treatment

#### A. The *Open Skies* Case

In *Commission of the European Communities v. Federal Republic of Germany*<sup>19</sup> (hereinafter referred to as the “*Open Skies* case” or “*Open Skies*”) the European Court of Justice (“ECJ”) held that, by entering into international commitments with the US (i) concerning air fares and rates charged by carriers designated by the United States on intra-Community routes, (ii) concerning computerized reservation systems (CRSs) offered for use or used in German territory, and (iii) recognizing that the United States has the right to withdraw, suspend or limit traffic rights in cases where air carriers designated by Germany are not owned by Germany or German nationals, Germany failed to fulfill its obligations under the EC Treaty and related regulations.<sup>20</sup> The first and second holdings were based on the fact that regulations issued by the EC Council (i) relating to the fares and rates and (ii) relating to CRSs, resulted in the European Community acquiring exclusive competence to enter into commitments with non-member countries concerning fares and rates to be charged by carriers of non-member countries on intra-EC routes.<sup>21</sup>

Thus, in a manner evocative of US Supreme Court analysis of constitutional law principles relating to the Supremacy and Commerce Clauses of the US Constitution, the ECJ determined that, by entering the relevant regulations, the Council has “occupied the field” and thus deprived the Member States of any ability to enter into international agreements relating to that subject matter.

However, the most interesting and relevant part of *Open Skies* for our purposes relates to the third holding, namely, that Germany breached its obligations under the EC Treaty and related regulations by recognizing the right of the US to withdraw, suspend or limit the traffic rights of carriers which are not owned by Germany or its nationals. In general, the ECJ based this holding on the principle of non-discrimination.<sup>22</sup> In

connection with that holding the ECJ cited two tax cases, *Saint-Gobain* and *Gottardo*, which are discussed below.

The ECJ reasoned that the EC Treaty guarantees non-discrimination, under which concept nationals of Member States must be accorded the same treatment in a Member State as that accorded to the Member State’s own nationals, both in regard to access to an occupational activity and the exercise of such activity.<sup>23</sup> The ECJ noted that it previously had held, in the cases of *Saint-Gobain v. Finanzamt Aachen-Innenstadt* and *Gottardo v. Istituto nazionale della previdenza sociale*, that such a principle of “national treatment” requires a Member State which is a party to a Tax Treaty with a non-member country to grant to permanent establishments of companies resident in another Member State the advantages provided for in that treaty on the same conditions as those applying to its own residents.<sup>24</sup>

The offending clause in Germany’s *Open Skies* Treaty with the US permits the United States to restrict operating authorizations or technical permissions of airlines having a substantial ownership or effective control by other Member States or non-German nationals, while requiring the United States to grant the appropriate operating authorizations and technical permissions to airlines which are substantially owned and effectively controlled by Germany or German nationals.<sup>25</sup> Consequently, airlines of other EC members may always be excluded from the benefit of the air transport agreement between Germany and the United States, while the benefit is provided to German airlines, with the result that the EC member airlines suffer discrimination which prevents them from benefiting from the treatment which under the treaty Germany accords to its own nationals.<sup>26</sup> Furthermore, even though the “discrimination” would result from an action by the US, the ECJ determined that “the direct source of that discrimination is not the possible conduct of the [United States] but the clause [in the Treaty] on the ownership and control of airlines, which specifically acknowledges the right of the [United States] to act in that way.”<sup>27</sup> Thus, the ECJ held that a treaty entered into by a Member State, which grants a non-member country the right to provide disparate treatment to other EU Member States and their nationals, violates the non-discrimination principle.

#### B. Application of Non-Discrimination Rule in EC Tax Cases

As noted above, the ECJ relied in part on two prior tax cases. The first of these, *Saint-Gobain*, held the EC Treaty precludes the exclusion of a permanent establishment in Germany of a corporation of another Member State from enjoyment, on the same conditions as those applicable to German corporations, of certain tax con-

cessions provided by a tax treaty with a non-member country.

As a preliminary matter, the ECJ stated that, in the absence of unifying or harmonizing measures adopted in the EC, the Member States have the competence to determine the criteria for taxation of income and wealth with a view to eliminating double taxation by means, among others, of international agreements. Such Member States also are free within such bilateral agreements to determine the connecting factors for purposes of allocating powers of taxation as between the parties to such agreements.<sup>28</sup> Nevertheless, in the exercise of such power, Member States may not disregard EC rules.<sup>29</sup> One of these rules, the “national treatment” principle, requires Member State parties to such treaties to grant to permanent establishments of non-resident companies the advantages provided by that treaty on the same conditions as those which apply to resident companies.<sup>30</sup> The ECJ stated that the balance and the reciprocity of the treaties concluded by Germany with non-member countries would not be called into question by a unilateral extension, on the part of Germany, of the tax advantage provided by those treaties (there, corporation tax relief for international groups), since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.<sup>31</sup>

The second case, *Gottardo* involved a dispute between Mrs. Gottardo, a French national, and the Italian National Social Security Institute (“INPS”) concerning Mrs. Gottardo’s entitlement to an Italian old-age pension. In general, the ECJ held that in determining the right to old-age benefits the social security authorities of one Member State must take into account periods of insurance completed in a non-member country by a national of another Member State, if under identical conditions such periods would be taken into account in the case of their own nationals pursuant to a treaty between such Member State and the non-member country.<sup>32</sup> Thus, in *Gottardo* the ECJ applied the non-discrimination principle to provide nationals of other Member States the same benefits which the Member Country accorded to its own nationals pursuant to a bilateral treaty with a non-EC country. The ECJ noted that, although direct taxation is within the competence of the Member States alone, they may not disregard EC rules and must exercise their powers consistently with EC law.<sup>33</sup>

Further, in connection with an agreement between a Member State and one or more non-member countries, Member States generally are required to comply with EC law. The fact that non-member countries, for their part, are not obliged to comply with any EC law obligation is of no relevance in this respect.<sup>34</sup> The fundamental principle of equal treatment requires that a Member

State grant nationals of other Member States the same advantages that its own nationals enjoy under a bilateral convention with a non-EC country unless it can provide objective justification for refusing to do so.<sup>35</sup> The ECJ, citing *Saint-Gobain*, noted that “disturbing the balance and reciprocity of a bilateral international convention” between a Member State and a non-member country may constitute an objective justification for the refusal by such Member State to extend to nationals of other Member States the advantages which its own nationals derive from that convention. However, in this case Italy could unilaterally extend to workers who are nationals of other Member States the benefit of having insurance periods completed in Switzerland taken into account for Italian old-age benefits without compromising the rights that Switzerland derives from its bilateral treaty with Italy or imposing any new obligations on Switzerland.<sup>36</sup>

It should be noted that in both *Saint-Gobain* and *Gottardo* the discriminatory effect of the tax treaty could be remedied by a unilateral extension to the nationals of other Member States of the benefits provided to nationals of the non-member country under the bilateral treaty. However, in *Open Skies*, as well as in connection with the application of a limitation on benefits clause, such benefits cannot be provided to nationals of other Member Countries unilaterally by the Member Country which entered into the treaty with the non-member country, because the relevant treaty provisions reserve to the non-member country (here, the United States) the ability to impose such restrictions with respect to permanent establishments in the United States and US source payments which are not effectively connected with such a permanent establishment.

#### IV. LOB Provision under the US Income Tax Treaties with EC Member Countries

As noted above, the US Model Treaty provides for a “Limitation on Benefits” provision. Currently, such provisions, in one form or another, are contained in the bilateral income tax treaties between the US and the European Community Member Countries and candidates for EC membership, as listed on the attached Exhibit B. In addition, LOB provisions also are contained in US treaties with other countries which are not EC Members, as listed on the attached Exhibit C.

Generally, as noted above, the purpose of such provisions is to prevent parties which are not resident in either of the countries entering into the bilateral tax treaty from obtaining the benefit of the provisions of the treaty. Depending upon the treaty, these provisions can be rather complex. However, for purposes of illustration, the Income Tax Treaty between the US and Belgium provides a more simplified example.<sup>37</sup>



Article 12A was added to the US-Belgium Income Tax Treaty by the 1987 supplementary protocol.<sup>38</sup> This provision provides in general that, unless certain alternative conditions are satisfied, a person (other than an individual) which is a resident of the United States or Belgium and derives dividends, interest or royalties from the other country is not entitled to the benefits of relief from taxation provided under the dividends, interest, or royalties provisions of the treaty unless one of the following three tests is satisfied:

(a) Both (i) more than fifty percent of the “beneficial interest” in such person is owned by one or more individual residents of the United States or Belgium, or the governments of either country (including their political subdivisions or local authorities) or citizens of the United States (regardless of where resident) (the foregoing test is the “ownership test” and the foregoing beneficial owners are “qualifying persons”) and (ii) a “base erosion” test that no more than fifty percent of the gross income of such person is used, directly or indirectly, to meet liabilities for interest or royalties to persons who are not qualified persons; or

(b) The dividends, interest or royalties derived from the other country are derived in connection with, or are incidental to, the active conduct of a trade or business in such person’s country of residence by such person (but not including a business which principally consists of making or managing investments in the other country) (the “good business purposes test”); or

(c) The person deriving such dividends, interest or royalties is a resident of the United States or Belgium and either (i) its principal class of shares is substantially and regularly traded on a recognized securities exchange or (ii) more than fifty percent of each class of its stock is owned by a resident of the same Contracting State in which there is substantial and regular trading on a recognized securities exchange of such person’s principal class of shares.

The common thread of these tests is to provide the benefit to companies with a substantial relationship to one of the treaty countries, i.e., a company that is more than fifty percent owned by persons with residence in the applicable country (provided the base erosion test is met) or is actively engaged in business in the country

which is the source of such dividend, interest or royalty income or the stock of which is regularly traded by residents of those countries. These provisions are consistent with the LOB provisions of the US Model Treaty, discussed above.

The explanation of the 1987 supplementary protocol prepared by the Staff of the Joint Committee on Taxation (1988)<sup>39</sup> notes that this provision was intended to prevent so-called “treaty shopping” by residents of third countries by, among other things, establishing a corporation (or other entity) in one of the countries which, as a resident of such country, would be entitled to the benefits of the treaty. It also would be possible to reduce the income base of the treaty country resident by having it pay interest, royalties or other amounts which are deductible or not subject to withholding in one of the treaty countries. The provision is intended to limit the benefits of the reduced rates of withholding on dividends, interest and royalties to bona fide residents of the two countries, by providing that a person other than an individual (such as a corporation, partnership or trust) is not entitled to the benefits of such reduced rates of withholding unless it satisfies (i) an ownership and “base erosion” test, (ii) a “good business purpose test,” or (iii) a “public company test.” The effect of the ownership test is, for example, to deny the benefits of the reduced US withholding tax rates on dividends, interest, or royalties paid to a Belgium company that is controlled by individual residents of a third country. This rule is not as strict as that contained in the 1981 US Model Treaty, which required seventy-five percent ownership, by residents of the person’s country of residence, to preserve benefits.<sup>40</sup> As noted above, the 1996 US Model Treaty adopted a fifty percent ownership standard.

The “base erosion” rule is necessary to prevent a corporation, for example, from distributing most of its income through the use of deductible payments to persons not entitled to benefits under the treaty. Gross income for this purpose is defined to mean, in the case of the United States, gross income as defined in the Internal Revenue Code of 1986, as may be amended from time to time, without regard to the geographic source of the income; and in the case of Belgium, gross receipts, or in the case of a manufacturer or producer of goods, gross receipts reduced by the direct costs of labor and materials attributable to the manufacture or production and paid or payable out of those receipts. This provision is substantially similar to that in the US Model Treaty.<sup>41</sup>

Under the “good business purpose” test, denial of reduced rates of tax at source would not occur if the resident entity’s dividends, interest, or royalties are derived in connection with, or are incidental to, the active conduct of a trade or business in the residence

country. However, this exception does not apply (and benefits are therefore denied) to a business the principal activities of which are making or managing investments in the source country. The General Explanation noted that this active trade or business rule replaces a more general rule in the 1981 US Model Treaty and most recent (as of 1988) United States income tax treaties that preserves benefits if an entity is not used “for a principal purpose of obtaining benefits” under a treaty.<sup>42</sup>

Under the “public company” test, the term “recognized securities exchange” means any stock exchange registered with the US Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934, the NASDAQ system owned by the National Association of Securities Dealers, Inc., the Belgium stock exchanges, and any other securities exchange agreed upon by the competent authorities of the two countries.<sup>43</sup>

The foregoing description indicates that the LOB provision literally permits the United States to deny the benefits of this bilateral income tax treaty to entities established by persons which are not resident in Belgium, even if they are residents of another EC country. Under the anti-discrimination principles described by the ECJ in *Open Skies*, by agreeing to this provision (if the effective date of such treaty were after the effective date of the applicable EC rule), Belgium might be determined to have violated its obligations under the EC Treaty by permitting the United States to “discriminate” against such residents of other Member Countries. It appears that to comply with such obligations, the relevant treaty would need to be amended so that “qualified persons” as described above would include not only residents of Belgium but also residents of other EC Member Countries or which satisfy the foregoing tests based upon ownership by residents, an active trade or business, or substantial and regular trading on recognized securities exchanges in the respective Member Countries. It is not clear whether the United States would agree to such a broad provision.

## Endnotes

1. 1 Tax Treaties (CCH) ¶ 214.
2. See U.S. Treasury Dep’t, Technical Explanation of United States Model Income Tax Convention of September 20, 1996 (hereinafter “Technical Explanation”).
3. *Id.*, Technical Explanation at 3.
4. *Id.*
5. *Id.*, Technical Explanation at 102.
6. *Id.*
7. *Id.*, Technical Explanation at 102–03.
8. *Id.*, Technical Explanation at 103.
9. See Article 22(1) of the US Model Treaty and Technical Explanation at 104–05.
10. Article 22(2)(a) and (b) of the US Model Treaty.
11. 1 Tax Treaties (CCH) § 214A, Technical Explanation at 106–07.
12. *Id.*, Technical Explanation at 107.
13. Article 22(2)(c)(ii) of the US Model Treaty and Technical Explanation at 107–08.
14. *Id.*, Technical Explanation at 108–09.
15. *Id.*, Technical Explanation at 109.
16. *Id.*, Technical Explanation at 110–11.
17. *Id.*, Technical Explanation at 111–12.
18. The three ratios compare (i) the value of the assets, (ii) the gross income derived and (iii) the payroll expense, in each case in the recipient’s State to the corresponding item in the other Contracting State. The test first looks to the preceding taxable year, and it is satisfied if the average of the three ratios exceeds ten percent and each individual ratio exceeds seven and one-half percent. If such seven-and-one-half-percent test is not satisfied for any individual ratio, the average for the three preceding taxable years may be used instead. *Id.*, Technical Explanation at 115.
19. [2002] ECR I-09855.
20. *Open Skies*, note 19 *supra*, at paragraph 162.
21. *Id.* at paragraphs 124–25 and 128–31.
22. *Id.* at paragraphs 148–54.
23. *Id.* at paragraph 148, citing *Saint-Gobain v. Finanzamt Aachen-Innenstadt* [1999] ECR I-6161 at paragraph 35 (hereinafter “*Saint-Gobain*”).
24. *Open Skies*, note 19 *supra*, at paragraph 149, citing *Saint-Gobain*, note 22 *supra*, at paragraph 59, and *Gottardo v. Istituto nazionale della previdenza sociale (INPS)*, [2002] ECR I-413, at paragraph 32, (hereinafter “*Gottardo*”).
25. *Open Skies*, note 19 *supra*, at paragraphs 150 and 152.
26. *Id.* at paragraph 153.
27. *Id.* at paragraph 154.
28. *Saint-Gobain*, note 23 *supra*, at paragraph 56.
29. *Id.* at paragraph 57.
30. *Id.* at paragraph 58.
31. *Id.* at paragraph 59.
32. *Gottardo*, note 24 *supra*, at paragraph 39.
33. *Id.* at paragraph 32, citing *Saint-Gobain*, note 23 *supra*, at paragraphs 57 to 59.
34. *Gottardo*, note 24 *supra*, at paragraph 33.
35. *Id.* at paragraph 34.
36. *Id.* at paragraphs 36 and 37.
37. See 1 Tax Treaties (CCH) ¶ 1303.
38. See *id.* at ¶ 1340.
39. Staff of the Joint Committee on Taxation, Explanation of Proposed Protocol to the Income Tax Treaty between the United States and Belgium Scheduled for a Hearing before the Committee on Foreign Relations, United States Senate, on August 9, 1988, JCS-13-88 (1988) (hereinafter “General Explanation”).
40. General Explanation at 12–13.
41. *Id.* at 13.
42. *Id.* at 13.
43. *Id.* at 13–14.

**James R. Shorter Jr. is a partner in the New York office of Thacher Proffitt & Wood LLP, where he practices in the areas of tax, international business transactions, transportation finance, and equipment leasing.**

**Exhibit A**  
**1996 US Model Tax Treaty**  
**Article 22**  
**LIMITATION ON BENEFITS**

1. A resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by this Convention only to the extent provided in this Article.

2. A resident of a Contracting State shall be entitled to all the benefits of this Convention if the resident is:

- a) an individual;
- b) a qualified governmental entity;
- c) a company, if
  - i) all the shares in the class or classes of shares representing more than 50 percent of the voting power and value of the company are regularly traded on a recognized stock exchange, or
  - ii) at least 50 percent of each class of shares in the company is owned directly or indirectly by companies entitled to benefits under clause i), provided that in the case of indirect ownership, each intermediate owner is a person entitled to benefits of the Convention under this paragraph;
- d) described in subparagraph 1(c)(i) of Article 4 (Residence);
- e) described in subparagraph 1(c)(ii) of Article 4 (Residence), provided that more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State; or
- f) a person other than an individual, if:
  - i) On at least half the days of the taxable year persons described in subparagraphs a), b), c), d) or e) own, directly or indirectly (through a chain of ownership in which each person is entitled to benefits of the Convention under this paragraph), at least 50 percent of each class of shares or other beneficial interests in the person, and
  - ii) less than 50 percent of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State (unless the payment is attributable to a permanent establishment situated in either State), in the form of payments that are deductible for income tax purposes in the person's State of residence.

3.

- a) A resident of a Contracting State not otherwise entitled to benefits shall be entitled to the benefits

of this Convention with respect to an item of income derived from the other State, if:

- i) the resident is engaged in the active conduct of a trade or business in the first-mentioned State,
  - ii) the income is connected with or incidental to the trade or business, and
  - iii) the trade or business is substantial in relation to the activity in the other State generating the income.
- b) For purposes of this paragraph, the business of making or managing investments will not be considered an active trade or business unless the activity is banking, insurance or securities activity conducted by a bank, insurance company or registered securities dealer.
  - c) Whether a trade or business is substantial for purposes of this paragraph will be determined based on all the facts and circumstances. In any case, however, a trade or business will be deemed substantial if, for the preceding taxable year, or for the average of the three preceding taxable years, the asset value, the gross income, and the payroll expense that are related to the trade or business in the first-mentioned State equal at least 7.5 percent of the resident's (and any related parties') proportionate share of the asset value, gross income and payroll expense, respectively, that are related to the activity that generated the income in the other State, and the average of the three ratios exceeds 10 percent.
  - d) Income is derived in connection with a trade or business if the activity in the other State generating the income is a line of business that forms a part of or is complementary to the trade or business. Income is incidental to a trade or business if it facilitates the conduct of the trade or business in the other State.

4. A resident of a Contracting State not otherwise entitled to benefits may be granted benefits of the Convention if the competent authority of the State from which benefits are claimed so determines.

5. For purposes of this Article the term "recognized stock exchange" means:

- a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the US Securities and Exchange Commission as a national securities exchange under the US Securities Exchange Act of 1934; and
- b) [stock exchanges of the other Contracting State].

## EXHIBIT B

### I. LIST OF INCOME TAX TREATIES BETWEEN THE UNITED STATES AND EUROPEAN UNION COUNTRIES WHICH CONTAIN LIMITATION-ON-BENEFITS PROVISIONS

- A. AUSTRIA
- B. BELGIUM
- C. DENMARK
- D. FINLAND
- E. FRANCE
- F. GERMANY
- G. IRELAND
- H. ITALY
- I. LUXEMBOURG
- J. NETHERLANDS
- K. PORTUGAL
- L. SPAIN
- M. SWEDEN
- N. UNITED KINGDOM

### II. LIST OF INCOME TAX TREATIES BETWEEN THE UNITED STATES AND CANDIDATE COUNTRIES FOR EC MEMBERSHIP WHICH CONTAIN LIMITATION-ON-BENEFITS PROVISIONS

- A. CYPRUS
- B. CZECH REPUBLIC
- C. ESTONIA
- D. LATVIA
- E. LITHUANIA
- F. SLOVAKIA
- G. SLOVENIA
- H. TURKEY

## EXHIBIT C

### I. LIST OF INCOME TAX TREATIES BETWEEN THE UNITED STATES AND EUROPEAN UNION COUNTRIES AND EUROPEAN UNION CANDIDATES CONTAINING NO PROVISIONS ON LIMITATION ON BENEFITS

- A. GREECE (MEMBER)
- B. HUNGARY (CANDIDATE)
- C. POLAND (CANDIDATE)
- D. ROMANIA (CANDIDATE)

### II. LIST OF OTHER US INCOME TAX TREATIES WITH LIMITATION-ON-BENEFITS PROVISIONS

- A. AUSTRALIA
- B. BARBADOS
- C. BERMUDA
- D. CANADA
- E. CHINA
- F. EGYPT
- G. ICELAND
- H. INDIA
- I. INDONESIA
- J. ISRAEL
- K. JAMAICA
- L. KAZAKHSTAN
- M. KOREA
- N. MEXICO
- O. MOROCCO
- P. NEW ZEALAND
- Q. NORWAY
- R. RUSSIA
- S. SOUTH AFRICA
- T. SWITZERLAND
- U. THAILAND
- V. TRINIDAD AND TOBAGO
- W. TUNISIA
- X. UKRAINE
- Y. VENEZUELA

### III. LIST OF OTHER US INCOME TAX TREATIES CONTAINING NO PROVISION ON LIMITATION ON BENEFITS

- A. COMMONWEALTH OF INDEPENDENT STATES (CIS)/FORMER USSR
- B. HONDURAS
- C. JAPAN
- D. PAKISTAN
- E. PHILIPPINES

# The Dutch Enterprise Chamber: Key Player in Takeover Disputes

By Scott V. Simpson, Alexander J. Kaarls, and Paul J. van de Grampel

## I. Introduction

Before the battles involving Gucci, Rodamco and HBG, hostile takeovers were rare in the Netherlands, and the Dutch corporate, financial and investment communities frowned on such conduct. However, the Dutch takeover environment has changed significantly in recent years and a Dutch court has emerged as an important participant in contests for corporate control.

Beginning with the *Gucci* case, and continuing with, among others, the *Rodamco* and *HBG* cases, the Enterprise Chamber of the Amsterdam Court of Appeals (the “Enterprise Chamber” or “Court”) has played a key role in determining the outcome of disputes among acquirors, target companies and other stakeholders. Moreover, the decisions of the Enterprise Chamber in these cases have begun to provide a judicial framework for takeovers in the Netherlands. Although these developments are significant in their own right, because the Netherlands is an attractive jurisdiction for global businesses,<sup>1</sup> the decisions of the Enterprise Chamber have had, and are likely to continue to have, an impact on European takeover activity that extends beyond the borders of the Netherlands.

## II. Historic Perspective of Dutch Anti-takeover Devices

In comparison with many other European jurisdictions, Dutch law is relatively permissive in allowing the implementation by companies of anti-takeover devices.<sup>2</sup> Historically, virtually all Dutch publicly traded companies have implemented anti-takeover devices. Until recently, the Dutch financial and investment communities accepted the implementation of such devices without much debate. One reason for the acceptance of anti-takeover devices was the historic appreciation for action by consensus. In addition, Dutch boards owe a duty to the company and all of its stakeholders (rather than there being an emphasis on fiduciary duties toward the company’s shareholders). As Dutch boards must act in the best interests of the company and all of its stakeholders (including its employees, shareholders and creditors), for many years it was deemed appropriate for boards to execute these duties by protecting companies against hostile bidders through the implementation of anti-takeover devices.<sup>3</sup>

## III. Dutch Business-Judgment Approach to Takeover Defenses

The Netherlands currently does not have a takeover code like the United Kingdom, Italy, France or Germany.

Typically, in European jurisdictions where a takeover code is in place, a shareholder is required to make a full bid for all of a company’s shares as soon as the shareholder’s stake in the company exceeds a given threshold. As a result, where there is a takeover code, generally companies are not as free to engage in defensive measures.

Rather than following the takeover-code approach, Dutch law relies on “essential principles of good business judgment” (*elementaire beginselen van behoorlijk ondernemerschap*), as interpreted by the Dutch courts. Therefore, in accordance with the Dutch Civil Code the main Dutch law principle is that a company and its shareholders must act reasonably and fairly when dealing with each other.<sup>4</sup>

Takeovers and mergers in the Netherlands are also regulated by a set of rules laid down in the Securities Supervision Act 1995 (*Wet Toezicht Effectenverkeer 1995*) and the SER Merger Code (*SER-besluit Fusiegedragsregels 2000*). The relevant provisions of the Securities Supervision Act 1995 mainly provide for shareholder protection rules if a bid is launched; these rules include, for example, requirements with respect to the bid documentation and additional information that must be provided to shareholders. However, consistent with the Dutch Civil Code, the Securities Supervision Act 1995 does not provide for any shareholding thresholds that would trigger the obligation to make a full bid.<sup>5</sup>

Accordingly, the shareholders of a Dutch publicly traded company, as a general matter, are free to increase their stakes without being forced to make a bid, and Dutch boards are free to adopt anti-takeover devices in an attempt to prevent shareholders from acquiring control.<sup>6</sup>

## IV. Origins of the Enterprise Chamber

The Enterprise Chamber is a division of the Amsterdam Court of Appeals, specializing in corporate matters related to legal entities incorporated in the Netherlands. The Enterprise Chamber was established in 1971 with broad powers that allow it to intervene and order equitable relief or sanctions. Initially, the Enterprise Chamber mainly resolved disputes arising in the context of bankruptcy proceedings.<sup>7</sup> As a result, the Enterprise Chamber developed a substantial body of case law with respect to the liability of directors based on improper management resulting in the bankruptcy of companies.

In recent years, shareholders and Dutch companies have increasingly availed themselves of the Court’s abili-

ty to act quickly and decisively as well as the Court's developing expertise regarding the duties of Dutch directors; as a result, the Enterprise Chamber has become the forum of choice for litigation in a growing number of cases outside the bankruptcy context. Recognizing the expertise and broad authority of the Enterprise Chamber, disgruntled shareholders initially seized upon "investigation proceedings," provided for under Book 2 of the Dutch Civil Code, as a tool to resolve conflicts between a company and its stakeholders. (As part of an investigation proceeding, the Enterprise Chamber may order an investigation into the management policies and affairs of a company.)<sup>8</sup> More recently, shareholders and other stakeholders have used investigation proceedings in contests for corporate control, and in particular to challenge takeover defenses implemented by Dutch companies.

## V. Powers of the Enterprise Chamber

The Enterprise Chamber has extensive powers to correct corporate misconduct. The Enterprise Chamber can order a company to take certain actions to rectify a situation, either on an interim or permanent basis. Final measures ordered by the Enterprise Chamber may only be appealed to the Supreme Court of the Netherlands.

One of the most powerful tools available to the Enterprise Chamber is the so-called "investigation proceeding." Upon the written request of shareholders representing at least ten percent of a company's share capital (or who are entitled to an amount in shares or depository receipts with a nominal value of EUR 225,000 or such lesser amount as may be provided by the relevant company's articles of association), the Enterprise Chamber may order an investigation into the management policies and conduct of business at a company. The investigation is carried out by one or more Court-appointed investigators who conduct interviews with management, review files and examine relevant documents, stating their conclusions and recommendations in a report that is then submitted to the Court. The investigators are generally experienced business people, accountants and/or leading lawyers.

The Enterprise Chamber has broad discretion in determining whether or not to order an investigation. Actual suspicion of misconduct is not required. Doubts regarding the correctness of a company's management policies provide sufficient grounds for ordering an investigation. The Enterprise Chamber will order an investigation if there are "justified reasons to question the correctness" of the company's management policies. Examples of "justified reasons" include allegations of violations of law, financial reporting or accounting irregularities, potential insolvency, insufficient provision of information to shareholders or other stakeholders, and conflicts of interest involving the company, its management and/or its shareholders.

The Enterprise Chamber has the power to order temporary measures during the pendency of investigation proceedings. At the request of the party that initiated the proceedings, the Enterprise Chamber may at any stage, prior to ordering an investigation or pending the completion of an investigation, order preliminary relief measures that will remain in force for the duration of the proceedings. The Enterprise Chamber may also order preliminary relief measures at its own discretion and is not limited to the remedies requested by the petitioner. The scope and form of the remedies may be wide-ranging, and may include freezing voting rights, prohibiting the execution or implementation of an agreement, or suspending the efficacy of board resolutions.

If the Court-appointed investigators establish that mismanagement took place, the Enterprise Chamber may, at the request of the original petitioner or petitioners, order permanent measures, including the suspension or nullification of board or shareholder resolutions, the suspension or dismissal of directors, the temporary appointment of directors, deviation from specified provisions of the company's articles of association, and the temporary transfer of shares. Although the Court has broad discretion to order temporary measures, the Court is limited to a list of permanent measures specifically provided for by law.<sup>9</sup>

In recent years, the Enterprise Chamber's broad power to impose remedies has proven to be a major reason for corporate litigants to bring claims and petition for investigation proceedings in the Enterprise Chamber, particularly in takeover battles. In each of the *Gucci*, *Rodamco* and *HBG* cases, the requesting party sought to level the playing field by obtaining provisional rulings aimed at suspending defensive actions taken by the company. The Enterprise Chamber proved responsive in considering requests for provisional relief by convening initial hearings within days and ordering provisional measures directly following such hearings. Several Dutch legal scholars have noted the activist role taken by the Enterprise Chamber in recent years.<sup>10</sup> This activist role can be contrasted with the approach of the Dutch district courts, which have the ability to hear similar cases but may not have the same background and experience and generally have not tended to act as quickly or decisively (for instance, by ordering similarly far-reaching equitable relief).

## VI. The *Gucci*, *Rodamco* and *HBG* Cases

### A. The *Gucci*<sup>11</sup> Case

#### 1. Background

In the course of January and February 1999, one of the world's leading luxury goods groups, LVMH Moët Hennessy Louis Vuitton S.A. (LVMH), built up a stake of 34% in Gucci Group N.V. ("Gucci"). Gucci is an international holding company, incorporated and based in the

Netherlands, and is another leading global luxury goods group. Gucci is listed on Euronext Amsterdam and on the New York Stock Exchange. LVMH is Gucci's major competitor. Neither the Dutch rules nor the New York Stock Exchange listing rules provide for any mandatory bid requirements triggered by the acquisition of certain voting power in a listed company. In addition, Gucci's articles of association did not provide for any anti-takeover devices (except that Gucci's shareholders had delegated the power to issue shares to the board). Accordingly, LVMH could build up its 34% equity stake in Gucci without being required to launch a tender offer for all of Gucci's issued shares, while the 34% stake gave LVMH substantial control in any Gucci shareholder meeting.

## **2. Exercise by LVMH of Certain Shareholder Rights; Refusal to Make a Bid**

Since LVMH's stake in Gucci exceeded ten percent, LVMH had acquired the right, pursuant to Dutch law and Gucci's articles of association, to nominate members to the company's management and supervisory boards. Although LVMH stated that it did not intend to replace Gucci's management team or to acquire Gucci in full, LVMH demanded seats on Gucci's supervisory board. Gucci responded by insisting that LVMH either make a tender offer for all the Gucci shares or enter into a standstill and independence agreement intended to safeguard Gucci's continued independence from LVMH. LVMH refused to do either.

## **3. Gucci Launches ESOP**

Following unsuccessful negotiations, Gucci's board (in an unprecedented move) decided to issue new shares to a "friendly" employee trust or foundation, Stichting Belangen Werknemers (the "Gucci Stichting") pursuant to an Employee Stock Ownership Plan (ESOP). Under the ESOP, Gucci granted an option to the Gucci Stichting to acquire Gucci shares to match the stake held by LVMH, exercisable on a share-for-share basis. The Gucci Stichting immediately exercised its option. The issue of shares by Gucci to the Gucci Stichting was financed through the issuance by the Gucci Stichting of a note to Gucci.

Dutch law, generally, prohibits financial assistance by a company in the acquisition of shares in the capital of that company. However, Gucci relied on a special financing exemption provided in the Dutch Civil Code for shares issued to employees. Gucci's board had full power to authorize the ESOP share issuance, without shareholder approval, because Gucci's shareholders had delegated the power to issue shares to the board.<sup>12</sup> Generally, the New York Stock Exchange listing requirements require shareholder approval for the issuance of 20% or more of the capital of a New York listed company. However, as a foreign private issuer, Gucci was exempt from the shareholder approval requirement.

## **4. LVMH's Challenge Before the Enterprise Chamber**

LVMH immediately challenged Gucci's move before the Enterprise Chamber. In particular, LVMH challenged the legality of the ESOP share issuance and requested an investigation into Gucci's management policies. The use by LVMH of Enterprise Chamber investigation proceedings to challenge a company's defensive actions was unprecedented, and LVMH sought to take advantage of the Court's equitable power to neutralize the issuance of shares to the ESOP. In Gucci's pleadings before the Enterprise Chamber, Gucci counterclaimed that LVMH had abused its position as shareholder by not consulting with Gucci while LVMH built up its stake and by threatening Gucci's independence. Gucci argued further that the issuance of shares to the ESOP was an appropriate response to the threat posed. Gucci also sought to take advantage of the Court's equitable power and asked the Enterprise Chamber to suspend LVMH's voting rights.

## **5. Enterprise Chamber's Suspension of LVMH's Voting Rights Pending Final Ruling**

In its preliminary ruling of 3 March 1999, the Enterprise Chamber, pending its decision on whether or not an investigation would be warranted, suspended the voting rights on both the ESOP's and LVMH's shares. The Enterprise Chamber did not restrict the ability of Gucci's boards to issue new shares, despite a specific request from LVMH that the Court restrict Gucci's power in this regard. In addition, the Enterprise Chamber suggested that the parties commence negotiations with the aim of reaching a settlement prior to the Court's final ruling on the matter, which was scheduled for 27 May 1999.

## **6. Gucci's Negotiations and Strategic Alliance with PPR**

Shortly after the ruling of 3 March, Gucci was approached by Pinault-Printemps-Redoute S.A. (PPR). PPR was interested in discussing a strategic alliance with Gucci, but was not willing to make a bid for all of the shares of Gucci.

Following two weeks of negotiations, Gucci and PPR announced that Gucci would issue new shares to PPR, equaling 40% of Gucci's outstanding share capital on a fully diluted basis against a \$2.9 billion cash contribution by PPR. In the Strategic Investment Agreement entered into between Gucci and PPR, PPR agreed to a standstill and a number of arrangements guaranteeing Gucci's independence. Accordingly, in Gucci's view, a full offer for all of the company's shares remained an option (whether by PPR, LVMH or a third party). PPR obtained board representation and limited veto rights over extraordinary decisions, while the majority of directors (including the chairman of the board) remained independent.

## 7. Further LVMH Litigation

Immediately following the announcement of the PPR transaction, LVMH filed an additional suit in the Enterprise Chamber, challenging the transaction, requesting the rescission of the share issuance to PPR, and requesting a freeze of PPR's voting rights. On the same day, LVMH announced that it would make a bid for all of the shares of Gucci. On 22 March 1999, the Enterprise Chamber, in an interim ruling, refused to grant most remedies sought by LVMH. However, the Enterprise Chamber lifted the suspension of LVMH's voting rights. In addition, the Court ordered that Gucci and LVMH enter into good-faith discussions on a possible LVMH bid for Gucci. The Court did not deem the PPR agreement a barrier to such a full offer. Between 22 March and the end of April 1999, Gucci and LVMH discussed multiple potential offers to be made by LVMH. However, each offer structure proposed by LVMH contained conditions that were unacceptable to Gucci. Ultimately, LVMH did not make a bid.

## 8. Final Ruling by the Enterprise Chamber

On 27 May 1999, the Enterprise Chamber issued its final decision. The Court held that the facts of the matter were sufficiently known and that ordering an investigation into Gucci's management policies would be pointless. In other words, the Court was prepared to rule from the bench. Respecting the ESOP, the Court found that, although the board was justified in taking action to defend itself against the uninvited stock accumulations of a major competitor, the voting power of the ESOP was disproportionate to the financial interests of the ESOP participants. The Court therefore annulled the company's actions in issuing shares to the ESOP. Respecting the PPR transaction, the Court found that the timing of the transaction was inappropriate and that Gucci's conduct in entering into the transaction when it did constituted mismanagement. However, the Court found that the company had the power to enter into the PPR transaction generally. Therefore, the Court let the PPR transaction stand and determined that "there are no grounds for providing any relief in connection with Gucci having entered into the agreement with PPR."<sup>13</sup> The Enterprise Chamber also reviewed the negotiations conducted during March and April between LVMH and Gucci and concluded that LVMH had had a fair opportunity to make an offer for Gucci but had chosen not to make an unconditional offer. It also concluded that Gucci had conducted itself appropriately in the negotiations.

## 9. Appeals from the Enterprise Chamber Ruling

Both LVMH and Gucci appealed the Enterprise Chamber's decision to the Supreme Court of the Netherlands. LVMH claimed that, if the Enterprise Chamber held that the timing of the PPR transaction was inappropriate and constituted mismanagement on the part of Gucci, then the Enterprise Chamber should have come to the conclusion that the PPR transaction should be nulli-

fied. On the other hand, Gucci claimed that, if the Enterprise Chamber held that the PPR transaction in substance was an acceptable transaction, then the Enterprise Chamber had no basis to conclude that Gucci's entering into the transaction when it did so constituted mismanagement. In addition, Gucci claimed that the Enterprise Chamber, in accordance with Dutch law, is only allowed to rule that a corporate action constitutes mismanagement if such ruling is based on a formal report prepared by Court-appointed investigators. Similarly, Gucci argued that the Court could order any measures, such as the nullification of Gucci's actions in creating the ESOP, only on the basis of the investigators' final report. Since the Enterprise Chamber never called an investigation, Gucci argued, it could not conclude that any mismanagement had occurred and could not order any measures.

## 10. Reversal of Enterprise Chamber Ruling

On appeal, the Supreme Court overruled the Enterprise Chamber and held that, pursuant to the provisions of the Dutch Civil Code, the Enterprise Chamber may not rule from the bench and may only make findings of mismanagement, and order specific measures to correct conditions resulting from such mismanagement, on the basis of a full report prepared by Court-appointed investigators and concluding that mismanagement has occurred.<sup>14</sup> As the Enterprise Chamber had not ordered any such investigation, the Supreme Court ruled that the measures ordered against Gucci lacked proper basis.

## 11. Renewed Enterprise Chamber Litigation and Settlement

Following the Supreme Court ruling, LVMH re-filed its lawsuit against Gucci before the Enterprise Chamber. This time, in its ruling dated 8 March 2001, the Enterprise Chamber ordered an investigation into Gucci's management policies with respect to both the ESOP and the PPR transaction.

While the 2001 investigation was pending, Gucci, PPR and LVMH commenced negotiations, ultimately resulting in a September 2001 settlement. The settlement was fully supported by the Court-appointed investigators. Under the settlement, PPR agreed to purchase part of LVMH's stake in Gucci, to extend its principal standstill and independence commitments until 2004, and to make a bid for all of Gucci's outstanding shares in 2004. LVMH and Gucci ceased their miscellaneous litigation and the Enterprise Chamber terminated the pending procedure at the request of all parties involved (pursuant to the Enterprise Chamber's ruling of 26 October 2001).

As this article goes to press, PPR is in the process of making its bid for the remaining shares of Gucci in accordance with the September 2001 settlement.



## 12. Summary of Key Principles of Gucci Rulings

The following are highlights of key rulings in the Gucci matter.

- **Company's Right to Defend Against Hostile Shareholders.** In both its May 1999 ruling and its March 2001 ruling, the Enterprise Chamber considered that, as a general matter, a company has the fundamental right to implement defensive measures to prevent a hostile shareholder from obtaining control of the company. The Enterprise Chamber held that Gucci, in connection with its decision to defend itself, had the right to consider that LVMH owns businesses that compete with Gucci, and that LVMH was not willing to make a bid for all of Gucci's shares. In addition, according to the Enterprise Chamber, Gucci could determine that, in light of the distribution of Gucci's shares, LVMH's 34% stake in Gucci provided LVMH with effective control of the company. Against this background, the Court held that Gucci could reasonably determine that it was undesirable to allow LVMH to exercise any control rights in Gucci or to have an LVMH nominee appointed to Gucci's board. Accordingly, Gucci had the right to defend itself against LVMH.
- **Limitations on the Way in Which a Company May Defend Itself.** However, the Enterprise Chamber held, in both its May 1999 ruling and its March 2001 ruling, that specific measures aimed at defending a company against a shareholder obtaining control of that company may constitute mismanagement, depending on the way in which, and the circumstances under which, the company implements such measures. In particular, the implementation of measures violating mandatory rules of law may constitute evidence of mismanagement by the company.
- **Reasonable Expectations of the Company's Shareholders.** The Enterprise Chamber also held in both rulings that, in deciding whether defensive measures are allowable, one should take into account whether the target has preexisting defensive measures in place (which could be triggered by specific occurrences, and the existence of which is properly disclosed well in advance) or whether the target has a so-called "open structure" (i.e., no preexisting defensive measures in place). According to the Enterprise Chamber, if a target has such an "open structure," in deciding whether the execution by the target of defensive measures is nevertheless allowable, one should consider the rights and expectations that shareholders and prospective investors may have.

- **Reasonableness and Fairness Owed to both Shareholders and Company.** The Enterprise Chamber held that the principles of reasonableness and fairness are a two-way street: on the one hand, a company should take into account the interests of minority shareholders; on the other hand, an acquirer of a major interest in a company has a duty to inform the company of its intentions and consult with the company. Therefore, an acquirer that does not act reasonably and fairly vis-à-vis the company may be sanctioned by the Enterprise Chamber.

## B. The Rodamco<sup>15</sup> Case

### 1. Background

Rodamco North America N.V. ("Rodamco") used to be listed on Euronext Amsterdam and had an "open" corporate governance structure (that is, its articles of association did not include any specific anti-takeover devices). Rodamco invested in commercial real estate in the U.S., Canada and Mexico. As an investment company with a variable issued share capital, Rodamco could issue and repurchase its shares without shareholder approval.

### 2. Acquisition by Westfield of Rodamco Stake; Exercise of Shareholder Rights

During the summer of 2001, the Westfield Group, an Australia-based shopping mall owner ("Westfield"), negotiated with Stichting Pensioenfonds ABP, the largest Dutch pension fund ("ABP"), the acquisition from ABP of part of the approximately 30% interest that ABP held in Rodamco. At the same time, Westfield developed a comprehensive strategic plan for Rodamco, which included proposals to reduce Rodamco's debt-to-equity ratio, provide access to new capital, and increase profitability. Westfield then presented its strategic plan to Rodamco's board. Following these discussions, Westfield purchased a 23.9% Rodamco stake from ABP (while ABP retained a 6.6% interest) and informed Rodamco that it wanted to present its strategic plan concerning Rodamco directly to other Rodamco shareholders. Westfield demanded that Rodamco call a general meeting of shareholders so that Westfield could present its strategic plan to the shareholders and propose that Rodamco's board members be replaced. Rodamco refused to call the meeting.

### 3. Rodamco Share Issuance

On 24 September 2001, Rodamco issued ordinary shares at nominal value to a "friendly" trust ("Stichting RNA") in an amount equal to the number of shares held by Westfield and ABP, neutralizing their combined voting power. Rodamco had formed Stichting RNA shortly before the issuance. Rodamco also organized and financed a group of minority shareholders to promote

the interests of Rodamco shareholders (“SBBR”) and amended the terms of various employment agreements with senior Rodamco executives to provide enhanced compensation in the event of a “change of control” of Rodamco.

#### **4. Westfield’s Commencement of Proceedings Against Rodamco**

After the share issuance, Rodamco continued to refuse to convene a shareholders’ meeting, and did not respond to a standstill settlement proposal made by Westfield that included assurances vis-à-vis independence, conflicts of interest, and further purchases of Rodamco shares. On 8 October 2001, following the failed settlement proposal, Westfield initiated legal proceedings in the Enterprise Chamber, requesting an investigation into Rodamco’s management policies. In addition, Westfield requested the Court to order preliminary remedies that would prevent any changes in Rodamco’s corporate or voting structure pending the Court’s review.

#### **5. Enterprise Chamber’s Preliminary Ruling**

In its preliminary ruling of 16 October 2001, the Enterprise Chamber ordered an investigation into the policy and conduct of Rodamco’s management. The Court concluded that the share issuance was comparable to a protective preference share issuance, which was not provided for in Rodamco’s articles of association and was not approved by its shareholders. Furthermore, the Court found that the measures taken by Rodamco were primarily aimed at restricting Westfield’s shareholders’ rights and were contradictory to Rodamco’s open structure. The Court also held that the fact that a shareholder with a minority stake has de facto control in the general meeting was not sufficient to justify measures that neutralize the position of such shareholder. The Court elaborated by stating that this is especially the case where the shareholder has a substantial minority interest, is an expert in the business, and has the support of another minority shareholder. Therefore, the Court held that there were justified reasons to question the correctness of Rodamco’s management policies and ordered an investigation.

As a preliminary remedy the Court ordered Rodamco, pending the outcome of the proceedings, to recognize Westfield as a shareholder entitled to the rights attached to its shares. The Court acknowledged Rodamco’s assurances that it had no intention of changing the balance of power by taking extraordinary actions during the investigation. Therefore, the Court did not impose further preliminary remedies.

Consistent with general principles of Dutch law (and as reiterated by the Court in *Gucci*), an acquiror of a substantial interest in a company should take into account not only its own interests but also the interests of the company and other stakeholders. In light of this, the

Court ruled that a company is free to take measures against a minority shareholder whose intentions are not in line with this principle.<sup>16</sup> Therefore, the Court also ordered the investigators to investigate whether the defensive measures taken by Rodamco were justified in light of Westfield’s actions.

#### **6. Westfield’s Return to the Enterprise Chamber**

On 26 October 2001, in reaction to press releases and market intelligence regarding negotiations between Rodamco and third parties involving a potential sale of Rodamco, Westfield returned to the Enterprise Chamber. In its ruling of 15 November 2001, the Court reiterated that Rodamco was not free to take any actions that would change its fiscal position and corporate structure. Moreover, the Court stated that Rodamco could take actions in the ordinary course of business but could not take any actions aimed at any form of a material or significant transaction or material or significant cooperation with strategic partners. However, Westfield and Rodamco agreed, and the Court therefore acknowledged, that Rodamco could support a tender offer for all of its shares. Having confirmed these principles in the proceedings and related ruling, the Court did not order further preliminary remedies.

#### **7. Sale of 100% of Rodamco Assets; Final Ruling by the Enterprise Chamber**

During the Court-ordered investigation into possible mismanagement at Rodamco, Westfield reached a conditional agreement with two other property companies, Simon Property Group and The Rouse Company, regarding the cash purchase of all of the assets of Rodamco. The sale was negotiated with Rodamco, subject to the approval of Rodamco’s general meeting of shareholders. The parties proposed that, following the asset transfer to the joint purchasers, Rodamco would distribute the cash received to its shareholders and liquidate. Once agreement was reached on the asset sale, Westfield and Rodamco sought to terminate the Enterprise Chamber litigation. However, the Dutch shareholder activists association (VEB), which typically becomes party to these proceedings as an interested party, intervened and the Enterprise Chamber proceedings continued.

On 22 March 2002, following the completion of a report by the Court-appointed investigators, the Enterprise Chamber ruled that Rodamco had acted in violation of essential principles of good business judgment, resulting in mismanagement.

#### **8. Summary of Key Principles of Final Ruling**

The following are highlights of the Court’s final ruling in the *Rodamco* matter.

- **Company’s Right to Defend Itself.** The Court held that, in principle, the formation of Stichting RNA and the issuance of shares to Stichting RNA were

not unacceptable, as Westfield's strategy was not necessarily preferable to Rodamco's. Accordingly, Rodamco could seek to temporarily create a level playing field. (In setting forth these conclusions, it is worth noting that the Court did not address the open structure and character of Rodamco, which was one of the findings the Court initially articulated when it ordered an investigation into mismanagement).

- **Permanent Nature of the Defence.** However, the Court, consistent with the recommendations of the investigators, found that the share issuance was not intended to maintain the status quo but rather to keep Westfield out indefinitely. In light of this finding, the Court held that the formation of Stichting RNA and the share issuance were in violation of the essential principles of good business judgment and resulted in mismanagement.
- **Other Actions taken as Defence.** The Enterprise Chamber also held that SBBR was not an independent body and that therefore Rodamco's provision of financial support to SBBR constituted mismanagement. In addition, the Court held that the substantial increase of severance payments provided to Rodamco's management in case of a change of control constituted mismanagement.
- **Reasonable Expectations of a Substantial Shareholder.** The Enterprise Chamber held that Westfield, as a substantial shareholder, was justified in its expectations that Rodamco should have discussed with Westfield its strategic plans for the company. The investigators concluded that Rodamco had been unwilling to do so. Therefore, the Court concluded that Rodamco's management and supervisory board had not properly reviewed Westfield's proposed strategy and had, wrongly, not given Westfield the opportunity to present its proposals to Rodamco shareholders.
- **Sale of Assets.** The Court found that the sale of assets to Westfield, Simon and Rouse did not violate the Court's earlier rulings, which prevented strategic alliances, because the sale of assets was tantamount to a public bid which was not prohibited.

## 9. Supreme Court Partly Reverses Ruling of Mismanagement

Although the asset sale transaction went ahead, Rodamco (as well as each of its directors) appealed the Enterprise Chamber ruling to the Supreme Court of the Netherlands. In its ruling of 18 April 2003,<sup>17</sup> the Supreme Court reversed two of the three material grounds of the Enterprise Chamber's ruling of mismanagement.

- **Formation of Stichting RNA and the Issuance of Shares to Stichting RNA.** The Supreme Court quashed the Enterprise Chamber's finding of mismanagement based on (i) the permanent nature of Rodamco's defensive measures, and (ii) Rodamco's failure to discuss with Westfield its plans and provide Westfield with an opportunity to inform Rodamco's shareholders of its plans. The Supreme Court held that these findings were not supported by the investigators' report, and that the Enterprise Chamber had failed to conclude that the defensive measures were inappropriate under the circumstances.
- **Financial Support to SBBR.** In addition, the Supreme Court held that the financial support to SBBR was not intended to benefit certain shareholders but was an attempt, which is not illegal, to promote the board's position.
- **Amendments of (Employment) Agreements.** The Supreme Court upheld the Enterprise Chamber's ruling that the resolutions approving the increase of severance payments to key executives in case of a change of control constituted mismanagement as these resolutions disproportionately benefited Rodamco's board members and certain others to the detriment of Rodamco shareholders.

## C. The HBG<sup>18</sup> Case

### 1. Background

During the first half of 2000, Hollandsche Beton Groep N.V. (HBG) was in merger talks with one of its competitors, Koninklijke Boskalis Westminster N.V. ("Boskalis"). HBG was, among other things, engaged in the construction and dredging businesses. HBG's dredging activities were operated by its subsidiary Hollandse Aanneming Maatschappij B.V. (HAM). Boskalis was also active in the dredging business. The merger talks ended in July 2000 as a result of the parties' inability to agree on the proposed future of HBG's construction business. In September 2000, HBG issued a profit warning for the pending fiscal year and announced plans to drastically refocus its strategy. The HBG announcement triggered a new approach by Boskalis, with a proposal to enter into renewed merger discussions. In fact, Boskalis made two different offers for HBG's shares in HAM in February and May 2001. However, HBG rejected both of Boskalis' offers.

In HBG's general meeting of shareholders held on 23 May 2001, the Boskalis bid for HAM was discussed extensively. During the meeting, a number of substantial shareholders voiced their support for the Boskalis offer. HBG's board explained that it saw a number of issues with respect to the Boskalis bid, and it explained that its works council, as well as HAM's board and works council, objected to the acquisition of HAM by Boskalis. Dur-

ing the meeting, HBG's board stated that it wished to consider alternative options, but it did not discuss any specific alternative to the Boskalis bid.

## **2. HBG's Rejection of the Boskalis Bid**

In a press release of 31 May 2001, HBG announced that it would not accept Boskalis's bid and that it would pursue a joint venture between HAM and Ballast Nedam Baggeren B.V. This joint venture would lead to the formation of a new joint venture dredging business, Ballast HAM Baggeren B.V. HBG would hold two-thirds of the shares, and Ballast Nedam N.V. would hold one-third of the shares, in the joint venture company. In addition, HBG announced that it would call a general meeting of shareholders in which it would explain its decision to pursue the Ballast Nedam joint venture rather than accept the Boskalis bid.

## **3. HBG Approached by Heijmans**

Prior to the special meeting of shareholders, HBG management was approached by Heijmans N.V. ("Heijmans") regarding a proposed combination of the HBG construction activities with Heijmans's construction business. Heijmans's offer for HBG's construction business was conditional upon HBG's and Boskalis's reaching agreement on Boskalis's acquisition of HBG's (HAM) dredging business.

## **4. Special HBG Shareholders' Meeting; HBG's Pursuit of the Ballast Nedam Joint Venture;**

HBG organized a shareholders meeting to be held at the end of June 2001 to inform HBG shareholders regarding the proposed joint venture with Ballast Nedam. However, HBG did not ask shareholders to vote on the joint venture transaction because shareholder consent was not required under Dutch law. At the shareholders meeting, HBG's management discussed the reasons for its choice to combine the HAM dredging business with Ballast Nedam and it discussed the Boskalis offer. A number of HBG shareholders voiced strong objections against the Ballast Nedam joint venture. During the meeting, HBG's board rejected a proposal by shareholders to vote on the shareholders' views with respect to the proposed joint venture.

On 26 June 2001, shortly after the HBG special shareholders' meeting, HBG and Ballast Nedam entered into a memorandum of understanding (MOU) with respect to their dredging joint venture. The MOU followed from a confidentiality agreement relating to a possible transaction among the parties dated 27 December 2000.

## **5. Enterprise Chamber Proceeding by HBG Shareholders**

In July 2001, a number of HBG shareholders sued HBG before the Enterprise Chamber, petitioning for an investigation into HBG's management policies. The

Court found that, although the steps taken by HBG vis-à-vis the Ballast Nedam joint venture were not subject to shareholder approval as a matter of Dutch law, HBG's management should have carefully considered shareholders' objections. The Court ruled that there were justified reasons for questioning HBG's management policy and ordered an investigation. The Court-appointed investigators presented their report in August 2001. Although the investigators stated in their report that there were no reasons to conclude mismanagement, the investigators suggested that HBG take certain actions to regain shareholder confidence.

In response to the suggestions made by the investigators, HBG distributed an information memorandum and convened a special meeting to inform its shareholders of the reasons for the joint venture with Ballast Nedam. The information memorandum discussed why HBG preferred the Ballast Nedam joint venture over the Boskalis offer for HAM and why HBG decided not to enter into merger discussions with Heijmans. During the special meeting, a majority of HBG shareholders requested that HBG consider the offer received from, and enter into discussions with, Heijmans. In addition, a majority of shareholders requested HBG management to depart from its strategy to consider both the construction and the dredging activities as HBG's core business. In response to the shareholder demands, HBG management agreed to enter into discussions with Heijmans. However, HBG management insisted that it would not terminate its discussions with Ballast Nedam. HBG management also rejected the shareholders' request to depart from its core business strategy.

After the investigators submitted their report to the Enterprise Chamber, the petitioning shareholders requested the Court to conclude mismanagement and requested annulment of certain resolutions. Alternatively, the applicants requested the Court to order a further investigation. On 19 September 2001, the Enterprise Chamber ordered an additional investigation, following which the investigators (again) concluded that there was no basis to establish mismanagement. However, the investigators did conclude that HBG should have better communicated with its shareholders to avoid the rift with, and the lack of confidence among, its shareholders.

## **6. Enterprise Chamber's Final Ruling<sup>19</sup>**

In deviation from the recommendations of the two investigation reports, the Enterprise Chamber ruled on 21 January 2002 that HBG's lack of consultation with its shareholders prior to its decisions to reject the Boskalis offer and to enter into the Ballast Nedam joint venture, together with the loss of confidence among HBG shareholders, constituted mismanagement.

The Enterprise Chamber refused to order the dissolution of the Ballast Nedam joint venture, requested by a

number of shareholders. In connection with its ruling, the Court considered, among other things, that the failure to consult HBG's shareholders did not infringe a rule of law (since a shareholder vote is not required), which would have necessitated dissolution, and the Court noted that HBG had already been in joint-venture discussions with Ballast Nedam substantially before Boskalis announced its bid for HBG's dredging business. In addition, the Court considered that, notwithstanding the shortcomings with respect to the way in which HBG's board entered into the Ballast Nedam transaction, dissolving the joint venture would not remedy the board's mismanagement. Furthermore, the Court reasoned that the dissolution of the joint venture would not necessarily result in a successful bid by Boskalis for HBG's dredging business. This reasoning was based on the fact that HBG's board was opposed to consummation of the Boskalis transaction and, although the HBG board was required to properly inform HBG's shareholders, it did not need to submit the Boskalis offer to a shareholder vote. The Enterprise Chamber also considered that HBG's refusal to sell its dredging business to Boskalis did not frustrate a possible future third party bid for all or part of HBG.

## 7. Key Principles of Final Ruling

The following are highlights of the Court's final ruling in the *HBG* matter.

- **No Shareholder Approval or Consultation for Joint Venture.** The Enterprise Chamber considered that, as a general matter, a company does not need to obtain shareholder approval to enter into a joint venture as long as such joint venture does not materially change the character and business of the company as a whole. Moreover, the Enterprise Chamber considered that a company does not necessarily need to consult its shareholders before it enters into any such joint venture (although such consultation may be advisable from a good corporate governance and shareholder relations point of view).
- **Shareholder Consultation Prior to Rejection of Third-Party Bid.** According to the Enterprise Chamber, if a board intends to reject a third party's offer for a material part of the company's business, the board does not need to obtain shareholder approval (as the rejection will not lead to a material change in the business of the company). In such case, the Enterprise Chamber held that a board should consult the general meeting prior to making its final decision. If, however, a board were to consider accepting such offer, the board should obtain shareholder approval (as the acceptance would constitute a material change to the business of the company).

- **Information Provision to Shareholders.** According to the Enterprise Chamber, HBG's lack of communication with its shareholders regarding HBG's decision to enter into the Ballast Nedam joint Venture had resulted in a rift with, and lack of confidence among, its shareholders, which in turn constituted mismanagement on the side of HBG.

## 8. Supreme Court Quashes Enterprise Chamber's Final Ruling

HBG appealed to the Supreme Court, and on 21 February 2003, the Supreme Court overturned the Enterprise Chamber's final ruling. In its decision,<sup>20</sup> the Supreme Court considered, among other things, that there is no rule of Dutch law that requires a board to consult the company's shareholders in case it intends to reject a third-party bid for a part of the company. In addition, HBG's articles of association did not contain such a requirement. Accordingly, HBG did not have any legal obligation to consult its shareholders prior to entering into the Ballast Nedam joint venture.

With respect to the Enterprise Chamber's opinion that HBG'S lack of communication with its shareholders had resulted in mismanagement, the Supreme Court considered that the manner in which a listed company (such as HBG) reports to, and communicates with, its investors (through the public disclosure of annual and quarterly financials and through conducting shareholders' meetings) could, under certain circumstances, be inadequate and result in a breach of essential principles of good business judgment (which, in turn, would constitute mismanagement), in particular where a company continuously and systematically fails to fulfill such (public disclosure) requirements. According to the Supreme Court, HBG did not breach any obligations in this respect. The loss of confidence among HBG shareholders could not, by itself, carry a finding of mismanagement.

## D. Conclusions from the *Gucci, Rodamco* and *HBG* Cases

A number of key rules follow from the *Gucci, Rodamco* and *HBG* cases. Dutch companies may use anti-takeover devices when faced with a hostile acquiror in order to temporarily create a level playing field, especially if the acquiror does not respect the interests of the company or its other stakeholders. The use of anti-takeover devices may be allowable even if the company has no preexisting measures in place at the time a threat materializes, depending on the circumstances. Where a target company has an "open structure," it should consider the reasonable expectations of shareholders that may acquire substantial minority stakes. The target should discuss its concerns with the acquiror and may need to provide the acquiror with an opportunity to present its strategic plans to the target's shareholders. In any event, parties should engage in fair-play negotiations

and the target must ensure that its shareholders remain properly informed. However, a board is not required to consult its shareholders when it intends to reject a bid for (part of) its business. The target should, of course, ensure that any defensive devices it implements do not violate mandatory rules of Dutch law or the company's articles of association. An acquiror should disclose its intentions to the target and be willing to discuss its strategic plans, if any. Although an acquiring shareholder, through a substantial minority interest, may be able to control a target's general meeting, if it faces an uncooperative board, willingness to discuss a bid for the remaining shares will enhance its position.

## VII. Likely Role of the Enterprise Chamber in Future Corporate Battles

The Enterprise Chamber has shown itself an effective participant in takeover situations, willing to act quickly and decisively to achieve an equitable result. In addition, the threat of a Court finding of mismanagement makes the investigation procedure an attractive tool for disgruntled shareholders. Accordingly, the Enterprise Chamber has become, and is likely to continue to be, an important arbiter in Dutch takeover battles. The Court should be expected to play a key role in the interpretation of new Dutch and European legislation in the corporate governance and takeover fields, adding to the growing body of case law. As a result, and depending on the evolving position of the Dutch market within Europe, Enterprise Chamber decisions may have an impact well beyond the borders of the Netherlands.

## Endnotes

1. Favorable tax treatment of Dutch holding companies appears to be a key factor. In particular, the Netherlands is considered an attractive jurisdiction because of the tax treatment of group financing activities, the participation exemption available to Dutch holding companies, the exemption of foreign branch income and the absence of withholding taxes on interest and royalty payments on intellectual property rights.
2. The articles of association of Dutch incorporated companies may include anti-takeover devices. Public companies that are listed on Euronext Amsterdam may include in their articles of association only a choice from the limited number of protective devices allowed pursuant to Schedule X of the Euronext Amsterdam Listing Rules. Violation of Schedule X of the Listing Rules could ultimately result in delisting from Euronext Amsterdam. The anti-takeover devices that companies may put in place could include the following:

*Preference Shares.* A separate class of preference shares that become issuable when an unsolicited acquiror appears to be accumulating a substantial stake in the company's capital. Such a separate class of preference shares is commonly referred to as a class of "protective preference shares." Generally, the class would have a fixed dividend rate. Typically, the fixed dividend payable on protective preference shares, if and when issued, is sufficient to cover the interest on any loans taken out to finance the acquisition of the protective preference shares by the holder thereof, but low enough for the preference stock issuance not to materially

impact the company's valuation by analysts (other than on the basis of the protective character of the issuance). In addition, as a general matter, only 25% of the nominal value of the preference shares will need to be paid up when issued. The preference shares have the same voting rights as the ordinary shares in the capital of the company. When the company faces a threat constituted by the accumulation of stock by an unsolicited party, the company would issue protective preference shares to a "friendly foundation." The entity to which any preference shares would be issuable typically is a *stichting* formed under the laws of the Netherlands (an entity similar to a trust or foundation). Generally, the amount of shares issued to the "friendly foundation" would be sufficient, or exceed the amount necessary, to neutralize the unsolicited party's voting power. In most cases where companies have implemented the protective preference share anti-takeover device, the company has at the outset (when the device was put in place) entered into a stock option agreement with the "friendly foundation." In such case, if and when a hostile threat materializes, the "friendly foundation" can exercise the option and obtain control in the company's general meeting of shareholders. Typically, the company and the "friendly foundation" would also have entered into a further stock option agreement that provides for redemption of all preference shares as soon as the unsolicited acquiror has sold down his stake in the capital of the company or a friendly bid for all of the company's ordinary shares is consummated. Accordingly, the device is structured in such a way that any issuance of preference shares should have a de minimis impact on the economic dynamics and valuation of the company.

*Priority Shares.* The holders of priority shares are provided with specified priority voting rights on key corporate issues and the right to nominate board members. Accordingly, this class of shares can control the company and assure the company's "independence." Typically, the priority shares would be held by certain investors like venture capitalists, family members of the incorporators or a "friendly foundation."

*Depository Receipts.* Issuance of ordinary shares in the capital of the company to a legal entity known as a *Stichting Administratiekantoor* (an entity similar to a trust or foundation, like the entity to which any preference shares would be issuable or that could hold any priority shares). The foundation issues depository receipts without voting rights (with the cooperation of the company) as publicly traded securities. The shares underlying such depository receipts are held, and voted, by the foundation. The foundation issues one depository receipt for each share. The depository receipts carry economic benefits (i.e., dividend rights) and reflect the underlying economic value of the company, while the foundation exercises the voting rights associated with the shares. The use of this device has become considerably less popular among Dutch companies during recent years.

*Other Anti-Takeover Devices.* Additional anti-takeover devices used by Dutch publicly traded companies include voting limitations, poison pills and crown jewel constructions. These devices (in particular, poison pills and crown jewel constructions) appear less popular in the Netherlands, and potentially less effective if challenged in the courts,

than the other defensive measures described above. Another tool available to Dutch companies that has been used as an anti-takeover device is the power to issue shares. If the company's articles so provide, or the shareholders approve the appropriate open-ended resolution in advance, Dutch companies can retain the authority thereafter to issue an unlimited number of shares without preemptive rights for a period of up to five years without going back to shareholders in the context of a specific transaction. In response to Dutch corporate governance developments, in recent years, Dutch boards have tended to propose to shareholders (in the annual meeting) only delegations to the board of the right to issue shares that are limited in scope (e.g., up to twenty percent of the company's outstanding share capital) and in time (e.g., up to 18 months, to be extended annually).

3. In recent years, certain international groups incorporated prior to effecting the initial public offering of their equity securities have decided not to implement many of the available Dutch anti-takeover devices outlined in note 2 *supra*. One of the main reasons for a decision not to implement such devices is the relevant companies' (or the selling shareholders') concern that such devices could limit shareholder value. In addition, Dutch anti-takeover devices are subject to the ongoing discussion in the Netherlands aimed at improving corporate governance and an increased emphasis on shareholder value. Furthermore, future Dutch legislation may allow a shareholder that has owned at least 70% of a company's share capital for at least one year to request the Enterprise Chamber to nullify any defensive devices in order to allow the relevant shareholder to fully exercise its voting rights.
4. Section 2:8 of the Dutch Civil Code forms the basis of the principle in the *Gucci* and *Rodamco* cases that a shareholder acquiring a substantial stake in a target company should disclose its plans to, and discuss them with, the company and should take into account not only its own interests but also the interests of the company and its other stakeholders.
5. Compliance with the Securities Supervision Act 1995 is monitored by the Financial Markets Authority (*Autoriteit Financiële Markten* (AFM)), the former STE (*Stichting Toezicht Effectenverkeer*). The SER Merger Code is a quasi-statutory code of conduct, compliance with which is monitored by the Merger Committee of the Social Economic Council (*Sociaal Economische Raad*). The SER Merger Code mainly focuses on the relationship among acquiror, target and the various other stakeholders, such as a target's employees, when a bid is made.
6. Pursuant to the Major Holdings Disclosure Act 1996, an acquiror holding directly or indirectly an interest in the capital of a public company is obliged to disclose its holding if the percentage of its interest moves to another specified threshold (e.g., 5%, 10%, 15%) as a result of an acquisition or disposal of securities. The acquiror must promptly notify both the AFM and the company concerned of any such change.
7. With respect to companies such as Text Lite, Ogem, Vie d'Or and Bredero.
8. See discussion under Part V *infra*.
9. Supreme Court, *HR 1 maart 2002, Ondernemingsrecht 2002-9, Rechtspraak nr. 29* with annotation L. Timmerman.
10. S.M. Bartman, *De Rol van de Ondernemingskamer bij overnamegeschieden, Ondernemingsrecht 1999/5*, p. 140, and J.H.M. Willems, *De enquête procedure: een efficiënte dienstmaagd, Conflicten rondom de rechtspersoon*, Kluwer, 2000.

11. Enterprise Chamber of the Amsterdam Court of Appeals, Case Number 167/99 OK; 3 March 1999, 22 March 1999, 27 May 1999, 8 March 2001 and 26 October 2001; NJ 1999, 487; JOR 1999, 121, with annotation L.L.M. Prinsen; LJN numbers AB0446 and AD4860 (available on <http://www.rechtspraak.nl>).
12. See note 2 *supra*.
13. Enterprise Chamber of the Amsterdam Court of Appeals, Case Number 167/99 OK; 27 May 1999; NJ 1999, 487; JOR 1999, 121, with annotation L.L.M. Prinsen.
14. Supreme Court, HR 27 September 2000, Case Number OK 80; LJN number AA7245 (available on <http://www.rechtspraak.nl>).
15. Enterprise Chamber of the Amsterdam Court of Appeals, Case Numbers 882/2001 OK, 882A/2001 OK and 882B/2001 OK; 16 October 2001, 18 October 2001, 15 November 2001, 24 December 2001, 13 February 2002, 22 February 2002 and 22 March 2002; LJN numbers AD4598, AD5815, AD7715, AD9247, AD9622 and AE0542 (available on <http://www.rechtspraak.nl>).
16. Whether this includes other shareholders is arguable since the Supreme Court (HR 13 November 1959, NJ 1960 472) has held that a shareholder may serve its own interest. See the note to this Court decision by J.M. Blanco Fernández in JOR 2001/251.
17. Supreme Court, HR 18 April 2003, Case Number R02/045HR (OK 104); LJN number AF2161 (available on <http://www.rechtspraak.nl>).
18. Enterprise Chamber of the Amsterdam Court of Appeals, Case Numbers 591/2001 OK and 810/2001 OK; 4 July 2001, 19 July 2001, 1 August 2001, 3 August 2001, 19 September 2001, 18 October 2001, 26 October 2001, 7 November 2001 and 21 January 2002; LJN numbers AB2476, AD3597 and AD8368 (available on <http://www.rechtspraak.nl>).
19. Since the final ruling, HBG has been subject to a completed tender offer for all its shares by the Spanish construction company Grupo Dragados S.A. Following the acquisition of (a part of) Dragados by ACS, a large Spanish conglomerate, HBG was sold to BAM NBM, a Dutch construction company. Ballast Nedam sold its minority stake in the joint-venture Ballast Ham Baggeren B.V. to HBG (BAM NBM). For an overview, see *Het Financieele Dagblad*, 7 October 2002.
20. Supreme Court, HR 21 February 2003, Case Number OK 101; LJN number AF1486 (available on [www.rechtspraak.nl](http://www.rechtspraak.nl)).

**Scott V. Simpson is a corporate partner in the London Office of Skadden, Arps, Slate, Meagher & Flom (UK) LLP. Alexander J. Kaarls is a corporate partner in the London Office of Houthoff Buruma and former corporate associate in the London Office of Skadden, Arps. Paul J. van de Grampel is a former corporate associate in the London Office of Skadden, Arps. Skadden, Arps acted as international counsel to Gucci and Westfield in the cases referred to herein, but the views, opinions and positions expressed in this article are those of the authors and not of Skadden, Arps or its clients. Mr. Simpson is admitted to the New York Bar, Mr. Kaarls is admitted to the Amsterdam Bar and the California Bar, and Mr. Van de Grampel is admitted to the Amsterdam Bar and the Supreme Court of England and Wales. All Rights Reserved. The authors may use significant portions, or the entirety, or adaptations, of this article in client mailings, publications, speeches and similar communications.**

# Structuring Mineral Exploration and Development Joint Ventures in Latin America—An Overview or How to Avoid Putting a Square Peg into a Round Hole

By Hugh Brooke Macdonald

## I. Introduction

This article explores the principal business organization forms available for structuring a mineral exploration and/or development joint venture in a Latin American country. The topics discussed include (i) terms of a hypothetical but common business deal in the international mineral exploration industry; (ii) a brief overview of common law unincorporated (contractual) and incorporated (equity) joint ventures used to document mineral exploration deals in the United States and Canada; and (iii) contractual and equity civil law joint venture structures that can be used in Latin America to achieve similar results.

Spending on mineral exploration worldwide is increasing again, fueled by increased demand and higher prices for base and precious metals. Total spending for 2003 is conservatively estimated to reach \$2.19 billion (based on budgets of 917 companies), down from a peak of \$5.2 billion in 1997 but a significant increase over 2002 spending of \$1.73 billion. Approximately \$517.9 million or 23.6% of the 2003 total is earmarked for Latin America, making it the most popular destination for exploration dollars, with Canada coming in a close second.<sup>1</sup> The funds will be spent in a variety of very different countries, some with long mining traditions like Bolivia, Chile, Mexico and Peru, and others that are relative newcomers as recipients of foreign direct investment in the mineral exploration sector.

Despite sometimes sharing a common language and a civil law tradition, each country in the Region has distinct mining laws and preferred joint venture structures of which the international mineral law practitioner should be aware. As a starting point, structuring an enforceable mining joint venture in a Latin American country requires a willingness to resist the temptation to simply translate the foreign investor's preferred mining form agreement into Spanish (or, in the case of Brazil, Portuguese),<sup>2</sup> or to execute an English language agreement between parent companies domiciled in common law jurisdictions (or between interposed holding companies in tax havens), hoping to later enforce a foreign judgment or arbitral award<sup>3</sup> in the civil law jurisdiction where the mineral property is located and where most of the contract obligations are to be performed. Good results sometimes can be obtained by having a local lawyer review a term sheet or letter of

intent and then adapt the substance of the deal to documentation consistent with local law and formalities. However, the legal nature of and rules applicable to the joint venture structure the local lawyer ends up selecting are not always well understood by the lawyer for the foreign mining company.<sup>4</sup>

Although beyond the scope of this article, it should be noted that the choice of joint venture structure is frequently driven by tax considerations. As a result, home<sup>5</sup> and host<sup>6</sup> country tax experts should be consulted early on regarding such issues as (1) the timing of the formation of the venture, and if and when to incorporate;<sup>7</sup> (2) whether to use an interposed holding company in a tax haven to provide tax planning opportunities;<sup>8</sup> and (3) whether to receive distributions from the venture in the form of interest on shareholder loans, dividends, payments for technical assistance, royalties, product (i.e., doré or concentrates), or some combination.<sup>9</sup> Foreign investment law considerations should also be taken into account.<sup>10</sup>

The choice of joint venture structure and your ability to incorporate standard business terms into the local documentation can also depend on the country and on who owns the mineral rights.<sup>11</sup> Certain structures that are tried and true in one country may not be recommended (or even available) in other countries. Or, the choice of joint venture vehicle may be predetermined at the outset. One example is when you are buying the interest of another investor in a joint venture already formed.<sup>12</sup> Another example is where the mineral rights are held by a state-owned corporation. In the latter situation, there may be a public tender that will dictate how much of a percentage interest the foreign mining company may earn and how the business arrangement will be structured. The tender documents may even fix a certain minimum-percentage "carried interest"<sup>13</sup> for the government and attach a model joint venture form that is mandatory and subject to limited negotiation.

## II. A Hypothetical Mineral Exploration Deal

Before examining the various legal structures available to miners in the Region, it is useful to first describe the essential terms of a hypothetical (but fairly typical) business deal to give some context to the search for the most suitable joint venture structure.



- The *El Dorado*<sup>14</sup> gold mining concession, located in the fictitious Republic of Corteguay, is wholly owned by a local corporation (“Minexco S.A.”) that is in turn wholly owned by a tax haven subsidiary (“Holdco”) of Canco Ltd., a Toronto Stock Exchange (TSX) listed junior<sup>15</sup> mining company (“Canco”).
- Mining concessions in the Republic of Corteguay are considered real-property rights granting exploration and exploitation rights for 25 years, subject to successive 25-year renewals, and may be freely transferred and encumbered to secure financing.<sup>16</sup>
- Following encouraging results of an early-stage diamond-drilling program reported in a press release, Canco has entered into a letter of intent with Big Mining Corp., a Denver-headquartered, New-York-Stock-Exchange-listed senior gold producer (“BMC”), pursuant to which BMC will be granted a four-year option to *earn* an initial 51% interest in the concession in return for making cash option payments and incurring certain minimum amounts on exploration (or paying Canco an equivalent amount in cash in lieu thereof). Amounts incurred in excess of the yearly minimums will be credited to future periods.
- BMC may accelerate the exercise of its option at any time as long as it pays all the cash option payments to Canco and incurs all the exploration expenditures (or pays any deficiency thereof in cash to Canco).
- Upon the vesting of the initial 51% interest, BMC and Canco will form a “joint venture” to conduct further exploration and feasibility work in respect of the concession.
- Canco will contribute the concession to the venture for an initial 49% interest, and BMC will contribute its exploration data package and expenses incurred for an initial 51% interest. The form of the joint venture will be agreed to in advance, based on legal and tax advice.
- BMC may increase its interest to 80% by funding a bankable feasibility study<sup>17</sup> leading to a mine-development (production) decision within three years after the vesting of its initial 51% interest.
- Canco will not be required to contribute additional funds until a production decision is made, at which time it will be required to provide 20% of the project financing, failing which it will suffer a dilution of its interest. If its interest is diluted to five percent or less, the interest will be automatically converted to a five-percent, non-voting, net profits interest.

### III. Common Law Unincorporated (Contractual) Mining Joint Ventures

What is a joint venture? To a business person, “a joint venture encompasses any business venture where there is an agreement between two or more parent firms (which remain separate entities) to engage in ongoing collaboration to pool complementary assets and/or skills for a common goal.”<sup>18</sup> To a lawyer, however, the term *joint venture* is almost meaningless in the absence of a corporate, partnership or contractual context that defines the legal relationship.<sup>19</sup> And, while courts in many common law jurisdictions have concluded that an unincorporated joint venture is simply a partnership<sup>20</sup> subject to the rules applicable to partnerships,<sup>21</sup> the joint venture agreements made among U.S.<sup>22</sup> and Canadian<sup>23</sup> mining companies go to great lengths to disavow and to contract out of the agency and fiduciary relationships and the joint and several liability applicable to partners,<sup>24</sup> and to affirm the partnership characterization for income-tax purposes only.<sup>25</sup>

The arrangement described in such agreements typically refers to an unincorporated association, formed to carry out exploration and/or development of a specific mineral property or properties located within a specific geographic area of interest, with the following characteristics:

- Common ownership of pooled assets (with undivided interests in the mineral property as tenants in common and record title held by one participant for the benefit of all participants).
- Several (as opposed to joint and several) liability. As among the participants, claims by third parties arising out of activities of the joint venture are borne in proportion to their respective undivided ownership interests in the joint venture assets, and each participant has a right of contribution and indemnity from the other participants.<sup>26</sup>
- Disclaimer of the doctrine of corporate opportunity, partnership and fiduciary relationships and the actual authority of any one participant to bind the others without their consent.
- Appointment of one participant (usually the one with the largest interest) as operator/manager of the venture with overall decision-making by a management committee, subject to certain qualified-majority-voting requirements (e.g., the minority participant can veto) on fundamental issues.
- The right to receive and market separately a proportionate share of the mineral production (a right that is sometimes waived in favor of sale of all production by the operator as an agent for all participants).

- Adjustment of interests according to a formula, e.g., for failure to meet cash calls on approved budgets.<sup>27</sup>
- Separate accounting of joint venture capital contributions, property, profits and losses.
- Partnership *flow-through* tax treatment.<sup>28</sup>

In addition to the tax advantage just mentioned, the unincorporated joint venture has the advantage of ease of formation and winding up. There is no cost to form or maintain an entity (e.g., annual filings with the Secretary of State's office), and the joint venture can be terminated with a letter. The chief disadvantage of the unincorporated joint venture is that it exposes the other assets of the participants to claims by third parties, as opposed to having their liability limited to their capital contributions if the joint venture were carried on through a corporation.

#### IV. Common Law Incorporated (Equity) Mining Joint Ventures

The Rocky Mountain Mineral Law Foundation has adapted its Form 5A to an equity joint venture, taking advantage of the flow-through tax advantages available in the United States to the limited liability company (LLC).<sup>29</sup> The operative agreements are a member's agreement (akin to a shareholder's agreement) and an operating agreement (akin to by-laws). The chief advantages of this hybrid entity are flow-through tax treatment like that for a partnership and limited liability like that of a corporation. The LLC also affords great flexibility as to management and capital structure. The chief disadvantages to using an incorporated (as opposed to a contractual) form of joint venture are the increased cost of formation, maintenance (e.g., annual filings with the Secretary of State, Division of Corporations Office) and winding up.

The participants to a contractual joint venture may also decide to incorporate at some point in the life of the project<sup>30</sup> (e.g., following a decision to capitalize expenses or immediately preceding or following a production decision), to limit their liability during the construction and operations phases of the venture.<sup>31</sup>

#### V. Civil Law Unincorporated (Contractual) Joint Ventures

##### A. Introduction

Even where all venturers are from developed countries and have significant attachable assets outside the jurisdiction where the mineral property is located, because the most valuable asset of the venture is the mineral deposit, it still makes sense to choose a contract form and a governing law that is well understood by

the local judges and/or arbitrators before whom a potential controversy may have to be argued. This is because, to be enforceable locally, rights in respect of the mineral property must be decided in accordance with local law.<sup>32</sup>

If an English language contract governed by the law of a U.S. state or a Canadian province is used, legalized<sup>33</sup> official translations and affidavits of foreign lawyers will be needed before the local court can render a decision. If suit is brought first in a U.S. or Canadian forum, the final decision (at least as it relates to the mineral property) will have to be enforced by a local court in any event. And if the decision relates to the mineral rights, the local court may refuse to enforce it on the basis that the *lex situs* should have been applied (or was misapplied by the foreign court), and/or that, the contract was not registered locally as required by law.<sup>34</sup>

Thus, as a practical matter it almost always makes sense to use a contract form in the local language that is tried and true in the local jurisdiction, executed and registered in accordance with the required formalities, with a non-exclusive submission to the jurisdiction of local courts or arbitrators.<sup>35</sup>

The question then becomes, what kinds of mining contracts are available? One respected Chilean commentator<sup>36</sup> has classified mining contracts as follows: (a) preparatory contracts, the purpose of which is to condition the execution or perfection of a later, more definitive contract (these include the bilateral contract of purchase and sale, the unilateral promise to sell and the unilateral option to purchase<sup>37</sup>); (b) contracts of disposition, the purpose of which is to alienate the mineral concession (these include the purchase and sale and swap of mineral concessions) or mineral substances (these include the purchase and sale of extracted minerals, and the lease and usufruct<sup>38</sup> of the concession); (c) contracts of association, i.e., joint ventures (these include the special contractual mining company); (d) contracts of credit (including the contract of *avío*<sup>39</sup>); and (e) contracts of guaranty (including the mortgage and the pledge).<sup>40</sup>

The focus in this Section V will be on the most widely used unincorporated joint venture structures, i.e., the *asociación en participación* (contractual limited joint venture), the *convenio de administración de bienes en copropiedad* (contract to administer assets owned jointly as tenants in common), the *consorcio* (consortium, cartel, syndicate), the *unión transitoria de empresas* (contractual joint venture—Argentina & Ecuador); the *unión temporal de empresas* (contractual joint venture—Colombia); and the *contrato de riesgo compartido* (contractual joint venture—Bolivia and Peru).

## B. *Asociación en Participación* (contractual limited joint venture)

The *asociación en participación*<sup>41</sup> is defined in the company laws or commercial codes of all of the civil law countries in Latin America<sup>42</sup> and the rules vary slightly from country to country. Generally, it exists where one person (the *asociado* or passive venturer) obtains a contractual participation in the profits and/or losses of one or more business enterprises of another (called the *asociante* or active venturer). The *asociación* is not an entity, and has no separate legal personality apart from the active venturer. The contract is a private agreement that requires no registration. The active venturer is liable for all of the debts of the venture, as a result of which a third party creditor has no direct cause of action against the passive venturer (unless the venture is carried on under a fictitious name, in which case the venturers can incur joint and several liability to third parties). The *asociación* keeps a separate set of books from the active venturer (which can be kept according to an agreed accounting guide, as negotiated).

The *asociación* is not a taxpayer. Each co-venturer is subject to tax at normal corporate rates on its distributive share of the net income of the *asociación*, and may deduct from income its distributive share of the net losses. Subject to tax advice both in the home and host countries, the *asociación* may be suitable as a vehicle to fund exploration of an active venturer subsidiary where the passive venturer parent company wants to limit its liability in the host country and needs to flow through the deductible expenses to offset against income from other ventures.<sup>43</sup>

It may also be suitable for exploration syndicates between two or more foreign investors, where the local subsidiary of the one with the largest stake acts as the active venturer and operator and holds the mineral title for the benefit of all participants. The chief disadvantage to the passive venturer is the lack of control and lack of direct ownership of the mineral rights, unless they are transferred to the passive venturer at the outset. In addition, unlike a silent partner in a limited liability partnership, the passive venturer in an *asociación* can be liable to the active venturer for its proportionate share of losses in excess of his contribution, unless limited by contract.

The *asociación* is not recommended for anything beyond exploration-stage work, and if used at all, should clearly state that the parties will form a corporation or other entity at some point if a production decision is anticipated,<sup>44</sup> and that the mineral rights will be transferred to that entity upon formation.<sup>45</sup>

## C. *Convenio de Administración de Bienes en Copropiedad* (contract to administer assets owned jointly as tenants in common)

This is a contract between two or more participants where each venturer owns an undivided interest (*derecho pro indiviso*) in the mineral rights and other assets as a tenant in common (*copropietario o comunero*).<sup>46</sup> Each venturer owns a mortgageable right to a share of the production (fruits) of the common operation, but may not alienate any part of the common property.<sup>47</sup> There is a right to partition, but it may be limited by contract.<sup>48</sup>

This figure lends itself nicely to adjusting percentage interests as option earn-in occurs and to standard dilution formulas.<sup>49</sup> Although the operator will deal with third parties, both venturers are liable to third parties for their proportionate share of the liabilities.<sup>50</sup>

At least one commentator does not recommend this figure for a mining venture in Chile.<sup>51</sup>

## D. *Consortio* (consortium, cartel, syndicate)

The *consorcio* is an imprecise term that historically did not form an integral part of the civil law.<sup>52</sup> Rather, it is defined in statutes and usually seen during the bidding stages of public tenders of large public works or natural resources projects.<sup>53</sup> For example, in Colombia<sup>54</sup> “[a] consortium exists] when two or more persons jointly present the same bid (proposal) for the adjudication, entering into and executing a contract, responding jointly and severally for each and every obligation arising out of the bid and the contract.”<sup>55</sup> It is not recommended for mining ventures.

## E. *Unión Transitoria de Empresas* (contractual joint venture—Argentina and Ecuador)

The *union transitoria de empresas* or “UTE,” an unincorporated (contractual) venture governed by statute,<sup>56</sup> is currently the favored vehicle for mining ventures in Argentina.<sup>57</sup> Foreign companies must either register a local branch or form a local subsidiary to participate in a UTE.<sup>58</sup> The contract must contain certain provisions.<sup>59</sup> Each venturer is liable for a share of the debts in proportion to his ownership interest in the assets contributed to the venture.<sup>60</sup> The contract and the designated representative of the venture must be registered.<sup>61</sup>

The UTE is also available in Ecuador.<sup>62</sup> Unlike the Argentine UTE, however, joint and several liability is presumed.<sup>63</sup>

## F. *Unión Temporal de Empresas* (contractual joint venture—Colombia)

Like the Argentine UTE, this contract had its roots in the Spanish *unión temporal de empresas*.<sup>64</sup> And like the

*consorcio* in Colombia, it is frequently mandated in connection with public tenders.<sup>65</sup> If a Colombian UTE is granted a mining concession, it must convert to a company.<sup>66</sup>

### G. *Contrato de Riesgo Compartido* (contractual joint venture—Bolivia and Peru)

The *contrato de riesgo compartido* is the prescribed statutory unincorporated mining venture form available in Bolivia<sup>67</sup> and Peru.<sup>68</sup>

## VI. Civil Law Incorporated (Equity) Joint Ventures

### A. Choice of Entity

Despite the existence of unincorporated joint venture forms, probably the most common form of business organization for a large mining venture in Latin America is still a corporation, or *sociedad anónima* or S.A.<sup>69</sup>

Less common for large ventures, but widely used throughout the Region nevertheless, is the limited liability company, or *sociedad de responsabilidad limitada* or S.R.L. Like an S.A., the members (or *cuota* holders) of the S.R.L. enjoy limited liability; unlike an S.A., there is no board of directors, only a general manager. Default rules in the company law govern in the absence of detailed by-laws governing, e.g., rights of first refusal on a capital increase or transfer of an interest. It is a taxable entity in most places (a notable exception is Chile, see below), but in most places the S.R.L. is *not* the equivalent of a U.S. LLC.

Chilean mining ventures are often organized as a *sociedad contractual especial minera* (special contractual mining company) or SCM. Despite the name, this is an equity joint venture with limited liability that is formed by registering an extract of articles that must contain specified information, including the contribution of the mineral concession to the capital of the entity, the number of shares held by each shareholder and how the entity will be managed.<sup>70</sup> The SCM is treated like a partnership for Chilean income-tax purposes.<sup>71</sup>

### B. Shareholders' Agreement

A shareholders' agreement should be executed at the same time as the option agreement, to come into effect upon the optionee's earning an interest in the mineral property. The shareholders' agreement functions as a road map and should include provisions covering the following areas:

- Formation of the entity<sup>72</sup> and initial capital contributions.<sup>73</sup>
- Direction and management of the entity.<sup>74</sup>

- Budgets and work programs for pre-feasibility studies, feasibility studies and the process leading to a production decision.
- Dilution provisions for failure to contribute to approved work programs.<sup>75</sup>
- Project financing (including the terms of any requirement to provide a sponsor's completion guarantee to project lenders).
- Pre-emptive rights on capital increases and transfer of an equity interest.

### C. Articles

While investors are naturally reluctant to put the terms of their business deal in a public document for the whole world (including their competitors) to see, to the extent key provisions such as preemptive rights are reproduced in the articles, the company itself may be able to enforce the obligation against a defaulting shareholder. Moreover, any provisions to have effect against third parties must be in the articles to give constructive notice. Where all participants are sophisticated listed mining companies with attachable assets in the United States or Canada or any other country with a transparent judicial system and effective judicial remedies, the shareholders' agreement could be in English governed by the law of the place where the assets are located (except for matters concerning title to the mineral property, which should be governed by the *lex situs*),<sup>76</sup> with a non-exclusive submission to litigate or arbitrate disputes in that forum.

## VII. Other Considerations; Conclusions

Helping your mining company client acquire an interest in mineral rights in a Latin American country and then develop a project jointly with a third party not only requires the selection of competent local counsel and an understanding of the business goals the client wishes to achieve; an awareness of the comparative law implications is also essential. This article has attempted to explore some of the issues to be discussed with local counsel. Other considerations, not discussed in this article, include the scope of required environmental permits and local labor laws, whether loans and foreign direct investment need be registered,<sup>77</sup> and whether the location of the mineral property<sup>78</sup> gives rise to any additional complications.

## Endnotes

1. *Corporate Exploration Strategies*, published in 2003 by the Metals Economic Group (MEG), cited in an editorial entitled "Canada leads way as exploration spending rises," published in *Northern Miner* at 4 (14-20 Nov. 2003) (the title of the article reflects the fact that, although Latin America constitutes the largest percentage of exploration expenditures, Canada's share in 2003 grew at a faster rate from 2002).

2. Doing so runs the risk that a civil law judge in the host country may misinterpret any gaps in the contract drafted by the common law lawyer, and find legal relationships that the parties did not intend. This can occur for a variety of reasons, including differences in legal training and inexact translations of common law concepts that have no exact equivalent in the civil law. For example, if no (or an inaccurate) translation of the term “joint venture” is included (which term, as noted below at Part III, is meaningless even in the common law in the absence of further definition) and if all the respective rights and obligations are not clearly spelled out, the judge could view the relationship as involving (i) an *asociación en participación*, analogous to a contractual limited joint venture, with third party liability to the active venturer only (see Part V.B. below); (ii) in Argentina and Ecuador, an unregistered *union transitoria de empresas* (see also note 58 *infra*), analogous to a contractual joint venture with several liability in Argentina and joint and several liability in Ecuador (see Part V.E. below); or even (iii) a *sociedad en nombre colectivo*, a general partnership with joint and several liability.
3. For a discussion of the relative merits of arbitration versus litigation, see *The Orchid Problem—Litigation versus Arbitration in the Americas*, 15 N.Y.S.B.A. International Law Practicum (2002); and Donald F. Donovan & David W. Rivkin, *International Arbitration and Dispute Resolution*, International Joint Ventures 2002 at 237 (Prac. L. Inst.). See also *Mining Law & Investment in Latin America*, 28-30 April 2003 (Lima, Peru), Rocky Mtn. Min. L. Found. (hereinafter “Rocky Mtn. Conference, Lima 2003”), specifically Papers 4A-D, namely, (i) Paper 4A: José Emilio Nunes Pinto, Tozinni, Freire, Texeira e Silva, Sao Paulo, Brazil, *Arbitration in Brazil and the 1958 New York Convention*; (ii) Paper 4B: Aurelio Martínez, Martínez, Córdoba y Asociados, Bogotá, Colombia, *The Arbitral Justice in Colombia: Alternative Dispute Resolution Systems*; (iii) Paper 4C: Samuel Lira Ovalle, Lira & Silva, Santiago, Chile, *Dispute Resolution and Mediation-Chile*; and (iv) Paper 4D: Thomas A. Doyle, Baker & McKenzie, Chicago, Illinois, USA, *Choosing the Proper Forum and Jurisdiction, and the Importance of Treaties and Enforcement of Arbitration Awards, a U.S Perspective—5 Significant Developments in International ADR*.
4. Differences in language, culture, legal training and experience with the mining business can all play a part in the understanding gap. Not infrequently, the lawyer for the foreign mining company speaks English only and is trained in the common law, while the lawyer for the owner of the mineral rights speaks Spanish and functional English and is trained in the civil law. The task is made easier when the local lawyer has a master’s degree in comparative law (or equivalent experience) and has experience with foreign investment in his or her country’s mining sector.
5. See generally William P. Streng & Jeswald W. Salacuse, *Forming the Foreign Business Organization—U.S. Tax Planning*, International Business Planning: Law and Taxation ch. 21 (Matthew Bender 2003). See also Alan M. Klein, *Structuring the International Joint Venture*, International Joint Ventures 2002 at 7 (Prac. L. Inst.); and Sally Thurston, *Tax Issues Associated with International Joint Ventures*, *id.* at 65.
6. See Rocky Mtn. Conference, Lima 2003, Papers 7A, B & C (relating to taxation of the mining industries in Chile, Mexico & Argentina, respectively). The Rocky Mtn. Conference, Lima 2003 also contains a good panel discussion (Paper 3) entitled *Structuring of Mining Ventures in Latin America*, moderated by James K. Aronstein. See also International Bureau of Fiscal Documentation (IBFD) in Amsterdam, The Netherlands, for summaries of the tax laws of selected Latin American countries.
7. Some investors prefer to form the venture only after exploration results under an option agreement warrant a more long-term commitment to the mineral property. By that time, however, the property may have appreciated in value due to publicly reported drilling results or a rise in metals prices to the point where the transfer of the mineral rights upon exercise of the option can give rise to a taxable event in the host country. Those investors that do form a venture early on may wish to consider using an unincorporated venture (or a hybrid entity recognized by their home country tax authorities as one qualifying the foreign exploration expenditures as tax deductible in the home country) during the exploration and feasibility stages of a project so that they can offset losses against their other income, and may prefer to incorporate to limit their liability upon making a decision to build a mine and processing facilities (called a “production decision”).
8. The tax haven holding company (the “Holdco”) can (1) serve as a dividend trap, capturing profits to be recycled back to other exploration and/or development ventures in the Region on a before-tax basis; and (2) allow for later, indirect, disposal of the investor’s interest in the joint venture, by permitting the sale of the investor’s shareholding in the Holdco, without thereby incurring a taxable gain in the host country on the sale of the shares of the subsidiary. This latter use of the Holdco may, however, be considered repugnant to host country tax administration officials, local politicians, NGOs and the media, if it is perceived to have been done solely for the purpose of avoiding paying the investor’s fair share of taxes in the host country.
9. This requires close analysis of the host country’s withholding tax rates on different income streams, whether and to what extent non-arm’s length transactions between related companies are penalized, and whether use of the Holdco structure will expose the project to greater government scrutiny.
10. Some countries offer important investment guarantees with respect to tax-rate stability and access to foreign exchange for the payment of interest, technical assistance fees, dividends and capital repatriation. See, e.g., Chile Decree/Law 600; Arg. Mining Investment Law 24.196/93; and Peru Legislative Decree 662.
11. For example, if your co-venturer that owns the mineral rights is another sophisticated foreign investor (e.g., a junior or senior mining company), it will understand that certain provisions (e.g., dilution of interest for failure to contribute its proportionate share of a work program) are standard and reasonable, and the structure of the venture will be determined largely on the basis of legal and tax advice as to how to best adapt local legal structures to the business deal agreed to in order to ensure enforceability. If, however, your co-venturer is an inexperienced local investor or a government entity in a country with little mining tradition (unlike a Codelco in Chile, for example), you may have a much harder time in the negotiations, as the co-venturer may be ignorant of what is considered standard and reasonable in the industry internationally, and (in the case of a government involved in a privatization by way of public tender) may have already predetermined and imposed the form and terms of the joint venture.
12. If the concession (or mining contract of work) is held by a local corporation in a country whose mining law requires prior approval to transfer the concession (e.g., Venez. *Ley de Minas*, Decree 295 of 5 September 1999, art. 29), the buyer may decide to buy shares, rather than the concession, to avoid an uncertain approval process.
13. A “carried interest” means an interest of one participant financed by the other participant(s). An example of such a definition (drafted by this author) is as follows:
 

“Carried Interest” means an Interest the holder of which:

  - (a) is not obligated, prior to a Production Decision (or, if appropriate: prior to completion of construction of a mine), to contribute funds to finance the cost of Operations;

and

(b) will not receive cash or in-kind distributions from the Joint Venture until Big Mining Corp. (“BMC”) or its permitted transferee shall have recouped, from 100% of the Net Cash Flow from Operations, the aggregate of all Allowable Costs incurred by BMC and its Affiliates on or for the benefit of the Properties (“Initial Payback”) including, without limitation, all costs of Exploration, Pre-Feasibility Studies, Feasibility Study, Development, Mining, Environmental Compliance and Continuing Obligations, plus interest thereon at LIBOR plus \_\_\_ percent (\_\_\_%) and then only to the extent of its Interest percentage of Net Cash Flow generated after Initial Payback occurs.

A variation of the concept would be a “free” carried interest, whereby one participant (sometimes a government entity, in consideration for contributing the mineral rights to the venture) is granted a small, fixed percentage voting interest that is not subject to dilution for failure to contribute to ongoing investment programs. This variation is rare, as most miners prefer to grant non-voting net-profits interests or net smelter return royalties.

14. “El Dorado,” meaning “The Gilded One,” is named after a legendary Indian king and his golden city (believed to be located somewhere between the Amazon and Orinoco rivers in northern South America) pursued by Spanish conquistadors in the mid-1500s.
15. A “junior mining company” is generally regarded in the industry as one that is not a subsidiary of a major mining company, is engaged primarily in mineral exploration and development activities (i.e., it is not yet a mine operator and has no self-sustaining cash flow), and raises most, if not all, of its funds through equity offerings. Unless exempted, juniors listed on the Toronto Stock Exchange (TSX) are subject to special reporting rules (requiring them to give prompt notice to the TSX of each proposed material change in the business or affairs of the company). See generally Toronto Stock Exchange Company Manual §§ 501–519 (Part V, Junior Listed Companies—Special Requirements for Non-Exempt Companies) & 314.1. Most juniors are listed on the TSX Venture Exchange (TSX-V), a national exchange for venture class securities. For a good overview of the TSX and the TSX-V, see Rocky Mtn. Conference, Lima 2003, Paper 15B, Laws, Regulations and Procedures for Listing Exploration and Mining Companies on Canadian Stock Exchanges, by W.S. “Steve” Vaughan, McMillan Binch, Toronto.
16. The constitutions of most, if not all, Latin American countries provide that minerals belong to the state, which may grant exploration and exploitation concessions (e.g., Bol., arts. 136–138; Chile, art. 24; Ecuador, art. 247; Guat., arts. 121(e), 125 & 142; Mex., art. 27; Peru, arts. 54, 66 & 73). The mining laws of some countries (e.g., Chile, art. 19(23) & (24)) treat concessions as real property rights of indefinite duration (subject to defeasance upon failure to pay a per-hectare patent or surface tax), that may be freely granted to the first applicant in time upon compliance with minimal formalities, and freely transferred and encumbered. The mining laws of other countries (e.g., Ecuador arts. 7 & 113; Guat. art. 17; Venez. art. 29) treat exploitation concessions as real property rights of limited duration (although in Venezuela transfer and encumbrance requires prior approval, see note 12 *supra*). Still other countries (e.g., Cuba: Ley No. 176 art. 17) treat concessions as mere administrative contracts, the transfer and encumbrance of which are subject to prior approval and bureaucratic discretion.
17. A bankable feasibility study is one that is in a form and of a scope generally acceptable to reputable financial institutions that provide financing to the mining industry. One definition (adapted from a Canadian model contract) is as follows:

*Bankable Feasibility, Study* means a report commissioned and approved by the Management Committee (or, if an equity joint venture: Board of Directors) containing a description and analysis of the methods and costs of bringing into production and operation a mine and associated mineral processing facilities on the Properties, which report, in the opinion of said Management Committee, would be in a form acceptable to a financial institution for project-financing purposes and which contains, without limiting the generality of the foregoing, detailed information on:

- (a) the estimated recoverable mineral products and estimated average composition and content of those mineral products;
  - (b) procedures for developing, mining and producing mineral products;
  - (c) results of metallurgical tests on ore samples;
  - (d) the machinery, equipment, other facilities and personnel required for production and marketing of those mineral products;
  - (e) the total estimated costs, including in respect of capital requirements, to purchase, construct and install the machinery, equipment and facilities referred to in paragraph (d) above, including a detailed schedule of all capital requirements with respect to those purchases; and
  - (f) a detailed economic feasibility study, which considers all costs and expenses including the matters referred to in paragraphs (a) to (e) above and any other matter the Management Committee reasonably considers to be relevant, including, without limitation, environmental protection and land reclamation requirements and the estimated financial return of mining the Properties.
18. See Barry Reiter & Melanie Shishler, *Joint Ventures, Legal and Business Perspectives* 19 (Irwin 1999) (Canada) (hereinafter “Reiter & Shishler”). According to Reiter and Shishler, business persons think of joint ventures more in terms of strategic alliances than in terms of legal structures. See also Erik P.M. Vermeulen, *Evolution of Legal Business Forms in Europe and the United States: Venture Capital, Joint Ventures and Partnership Structures* (Kluwer 2003) (stating, at 28, n. 78, that “[s]trategic alliances and joint ventures can both be described as contractual relationships between distinct organizations that provide for sharing the costs and benefits of a mutually beneficial activity”).
  19. See Reiter & Shishler, note 18 *supra*, at 19–20.
  20. See, e.g., *Pedersen v. Manitowoc Co.*, 25 N.Y.2d 412 (1969); *Ross v. Canadian Bank of Commerce*, [1923] 3 D.L.R. 339 (P.C.) at 342. See also Ralph H. Folsom & Michael W. Gordon, *International Business Transactions* § 20.1, 541 (West 1995).
  21. See generally Uniform Partnership Act (U.P.A.) ch. 38; Partnerships Act, R.S.O. 1990, c. ¶1.5, § 32(b) (Ont.).
  22. See, e.g., the Rocky Mountain Mineral Law Foundation’s Form 5A, Model Form Exploration, Development and Mining Agreement (“Form 5A”). Form 5A provides for joint ownership of the mineral property (i.e., undivided interests as tenants in common with recorded legal ownership in the name of one participant for the equitable benefit of all participants), joint operation (through a manager under the direction of a management committee), and a sharing of profits and losses. The model includes, among other things, provisions on representations and warranties, initial contributions, funding of approved programs and

- budgets, accounting guidelines, dilution and withdrawal, conversion of a participating interest to a royalty or net-profits interest upon dilution to a certain minimum specified level, acquisitions within the area of interest, restrictions on transfers of interests, and dispute resolution.
23. Due to differences in tax laws relating to the computation and allocation of items of income and loss, Canadian model forms use slightly different language. For a Canadian model, see Form 41:2 (Mining) Joint Venture Agreement found in O'Brien's Encyclopedia of Forms ch. 41, Mines and Minerals (Canada Law Book 11th ed.). Most senior Canadian mining companies and mining law practitioners have developed their own models.
  24. See, e.g., § 4.1 of Form 5A, note 22 *supra*, which provides as follows:
    - 4.1 No Partnership. Nothing contained in this Agreement shall be deemed to constitute either Participant the partner or the venturer of the other, or, except as otherwise herein expressly provided, to constitute either Participant the agent or legal representative of the other, or to create any fiduciary relationship between them. The Participants do not intend to create, and this Agreement shall not be construed to create, any mining, commercial or other partnership or joint venture. Neither Participant, nor any of its directors, officers, employees, agents and attorneys, or Affiliates, shall act for or assume any obligation or responsibility on behalf of the other Participant, except as otherwise expressly provided herein, and any such action or assumption by a Participant's directors, officers, employees, agents and attorneys, or Affiliates shall be a breach by such Participant of this Agreement. The rights, duties, obligations and liabilities of the Participants shall be several and not joint or collective. Each Participant shall be responsible only for its obligations as herein set out and shall be liable only for its share of the costs and expenses as provided herein, and it is the express purpose and intention of the Participants that their ownership of Assets and the rights acquired hereunder shall be as tenants in common.
  25. Section 4.2 of Form 5A, note 22 *supra*, provides as follows:
    - 4.2 Federal Tax Elections and Allocations. Without changing the effect of Section 4.1, the relationship of the Participants shall constitute a tax partnership within the meaning of Section 761(a) of the United States Internal Revenue Code of 1986, as amended. Tax elections and allocations shall be made as set forth in Exhibit C.
  26. In the absence of actual or constructive notice of the existence and terms of the joint venture, the relationship between the participants and third parties will be governed by the law of agency.
  27. E.g., ABC's percentage interest in the venture shall be equal to the total contributions of ABC x 100% divided by the total contributions of all participants.
  28. Like a partnership, an unincorporated joint venture is not a separate taxable entity. Rather, it is treated as the co-ownership of pooled assets for tax purposes, with each participant declaring its own share of the joint venture's gross revenues and expenses. This allows the venturers to offset profits and losses from their other businesses against the profits and losses derived from the joint venture, as opposed to being trapped in a corporation formed specifically for that venture. The advantage of this becomes apparent when one remembers the geologist's rule of thumb to the effect that exploring 100 mineral properties may yield five feasibility studies that may result in one operating mine.
  29. See generally Exploration, Development and Mining Limited Liability Company (Model Form 5A LLC), commentary and model form agreement, published by Rocky Mtn. Min. L. Found. (1998).
  30. The phases of a mining project are prospecting, exploration, pre-feasibility, feasibility, construction, operations, shut down, and environmental reclamation. See also note 7 *supra* and accompanying text.
  31. In this article, incorporation will be discussed only in the context of the most common corporate vehicles available for a mining venture in Latin America.
  32. See, e.g., Venez. Ley de Minas art. 33:
 

*En todo título minero se considera implícita la condición de que las dudas y controversias de cualquier naturaleza que puedan suscitarse con motivo de la concesión y que no puedan ser resueltas amigablemente por ambas partes, incluido el Arbitraje, serán decididas por los Tribunales competentes de la República de Venezuela, de conformidad con sus leyes, sin que por ningún motivo ni causa puedan dar origen a reclamaciones extranjeras.*

[Every mineral title shall be deemed to contain the implicit condition that all doubts and controversies of any kind that may arise concerning the concession that cannot be resolved amicably among the parties, including arbitration, shall be decided by the competent courts of the Republic of Venezuela in accordance with its laws, and shall not give rise for any reason or cause to foreign claims.]

See also Ecuador Ley de Minería arts. 112 & 217; Mex. Ley Minera art. 23; Dom. Rep. Ley Minera art. 8; Chile Código Civil art. 16, referred to by Cristián Quinzio S., Rocky Mtn. Conference, Lima 2003 (Paper 3, Chile, at 3-18).
  33. That is, it must be consularized or otherwise authenticated (e.g., affixed with an Apostille under the 1961 Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents).
  34. See note 32 *supra*.
  35. An exception would be where there is reason to doubt the transparency of the local court system and all parties are from countries with well developed and transparent legal systems and have significant assets in their home countries. In such a case, the parties may be more comfortable electing their home or a neutral country as the forum for the litigation or arbitration, and selecting the law of that forum as the governing law for most contract obligations and the *lex situs* as the law governing matters pertaining to ownership of the mineral property.
  36. Juan Luis Ossa Bulnes, *Derecho de Minería (tercera edición actualizada)* (1999) (Chile) [hereinafter "Ossa"].
  37. See *Código de Minería* (Cód. Min.) art. 169 (Chile), which covers both the unilateral promise to sell and the unilateral option to purchase. The principal difference (in Chile) between the unilateral promise to sell (*promesa unilateral de venta*) and the option to purchase (*opción de compra*) is that the latter requires only the acceptance by the optionee within the option period to complete the purchase, whereas the former requires the entering into of a further definitive contract of sale following exercise of the option, making the option to purchase the superior form. See also Ossa, note 36 *supra*, at 288-290. Both the written option (offer) and its exercise (acceptance) must be registered to perfect the sale (Chile Cod. Min. art. 169).

A registered option also could be used for the exercise of a “back-in right,” which gives a participant whose interest has been diluted the right to increase its interest to the pre-dilution percentage level by paying a premium. An example of a back-in right clause is as follows:

Before a feasibility study is completed, a participant whose interest has been diluted may elect to increase its interest to the percentage interest it held immediately prior to the most recent reduction (the “Back-In Percentage”) by contributing two (2) times its proportionate share (based on the Back-In Percentage) of the work plan in respect of which its interest was diluted.

38. Usufruct is the right in rem to the use and enjoyment of a thing, without altering its form or substance. The usufructuary gets something analogous to a real property interest for a term of years with a reversion in the grantor/owner, which is left with naked ownership (*nudo propiedad*). Third party purchasers take subject to the usufructuary’s rights if registered. Minerals are considered *natural fruits* of the land that may be consumed or disposed of by the usufructuary (Venez. Cód. Civ. arts. 583, 585 and 552). The usufructuary’s rights may be mortgaged and assigned (Venez. Cód. Civ. arts. 1,881 and 1,882). This device could provide a solution when the property is owned by a government agency that for legal or political reasons cannot be seen to be *selling the national patrimony* to a foreign investor. See also Ossa, note 36 *supra*, at 296.
39. The *Contrato de Avío* is in many respects the civil law rough equivalent of the common law grubstake contract, defined by Black’s Law Dictionary as follows:

*grubstake contract*. A contract between two parties by which one party provides the grubstake—money and supplies—and the other party prospects for and locates mines on public lands. Each party acquires an interest in the mine as agreed to in the contract.

Black’s Law Dictionary at 322 (7th ed. 1999 West).

The *Contrato de Avío* is recognized in the mining codes of both Argentina and Chile. Arg. Cód. Min., arts. 295 - 311: “*El avío es un contrato por el cual una persona se obliga a suministrar todo lo necesario para la explotación de una mina y el titular de ésta a devolver los valores recibidos con sus premios e intereses y/o transferir una parte de la mina y/o dar participación en sus productos.*” [Avío is a contract by which one person undertakes to supply all that is necessary for the working (exploitation) of a mine and the owner of the mine to return the values received with their premiums and interests and/or to transfer a part of the mine and/or give a participation in its products]. See also Miguel Ernesto Novoa & Maria Gabriela Novoa, *Manual de Derecho Minero* at 161 (1998) (Arg.) (hereinafter “Novoa”) (noting that the *Contrato de Avío* is infrequently used in Argentina, either because of the ignorance of investors about its availability or because of a preference for other forms, particularly the *Unión Transitoria de Empresas*).

Chile Cód. Min., art. 206–216: “*El avío es un contrato en virtud del cual una persona se obliga a dar o hacer algo en beneficio de la explotación de una pertenencia para pagarse sólo con sus productos, o con una cuota de ella.*” (Art. 206.) [Avío is a contract by virtue of which one person undertakes to give or do something for the benefit of the working (exploitation) of a claim, to be paid solely out of its products, or with an interest in the claim.] “*Puede estipularse que el pago de lo debido al aviador se verifique en minerales, en pastas o en dineros, con los premios que se convengan, sin límite alguno. Pueden también estipularse que, en pago del avío, el aviador se haga dueño de una cuota de la pertenencia, que puede llegar hasta el cincuenta por ciento de ella. Esta estipulación importa una promesa de compraventa, cuyo cumplimiento puede exigir el aviador, en conformi-*

*dad al artículo 169, una vez satisfechas por él las obligaciones que se impuso.*” (Art. 211) [The parties may agree that payments owed to the grubstaker be made in minerals, concentrates or in money, with any agreed premiums, without limitation. It may also be agreed that, in payment of the grubstake, the grubstaker becomes the owner of an interest in the claim, up to 50%. This stipulation implies a promise to sell, which the grubstaker may demand performance of, in accordance with article 169, once he has satisfied all of the obligations imposed on him.] See also Ossa, note 36 *supra*, at 333–339.

40. Ossa, note 36 *supra*, at 283–284.
41. Also called “*cuentas en participación*” in Costa Rica, Spain and Venezuela.
42. See, e.g., Arg. *Ley de Sociedades* No. 19,500, as amended by *Ley* 22,903 (hereinafter *Law 19,500*) arts. 361–366; Chile *Código De Comercio* [Cód. Com.], art. 507 et seq; Costa Rica Cód. Com., arts. 663–666; Guat. Cód. Com, Arts. 861–865; Mex. *Ley General de Sociedades Mercantiles* [L.G.S.M.] arts. 252–259; Venez. Cód. Com. arts. 359–364. According to a Venezuelan commentator, the figure also exists in the laws of Spain and Italy. See Roberto Goldschmidt, *Las Compañías de Comercio y Las Asociaciones en Participación, Anteproyecto Anotado de Ley de Reforma Parcial del Código de Comercio* (1955). The summary of the *asociación* referred to in this article is based on the Venezuelan *cuenta en participación*; the rules vary slightly from country to country.
43. E.g., Foreign Resource Expense (FRE) and Foreign Exploration and Development Expense (FEDE) in Canada. This author (on the advice of local counsel) has used this structure to document (i) exploration funding of wholly owned subsidiaries in Mexico, Chile and Venezuela by a Canadian parent company, and (ii) a mineral exploration joint venture between the respective Chilean subsidiaries of Canadian and Australian mining companies. In some countries, the *asociación* may be selected because the income stream of a passive venturer in an *asociación* may be subject to a lower rate of withholding at source than would income from a royalty granted to the parent company in consideration for funding exploration of its subsidiary.
44. The author (on the advice of local counsel) has used the *asociación* to document an exploration joint venture in Chile, where the parties attached the form of articles of a contractual mining company (SCM) to be used for any specific joint ventures spun off from the master exploration joint venture. See also Cristián Quinzio S., Rocky Mtn. Conference, Lima 2003 (Paper 3, Chile, at 3–15).
45. Because specific performance (sometimes called *acción ejecutiva de obligación de dar o de hacer*) may be unavailable as a remedy to compel a transfer of the mineral rights to the entity, the optionee may wish to require the optionor to grant an irrevocable power of attorney to the optionee, allowing the latter to transfer the property into its own name upon the vesting of its interest in the property under the option agreement. Because the power of attorney is coupled with an interest in the grantee (i.e., it is conferred to ensure enforcement of a promised obligation of the grantor), the power becomes irrevocable and the optionor may not revoke it. See, e.g., Venez. *Código Civil* [Cód. Cív.] art. 1,705. Penalty clauses can also be considered to compel performance. Unlike in the common law system, penalty clauses are (generally) enforceable in Latin America, even if in excess of a genuine estimate of damages (as long as the amount is not so grossly disproportionate as to be unconscionable). Another way to ensure transfer of the mineral rights is to create a financial incentive in the optionor (e.g., a carried interest, royalty, balloon payment) that vests upon the transfer of the mineral rights to the entity.
46. Venez. Cód. Civ. art. 759 et seq., Venez. *Ley de Minas* art. 31; Guat. Cód. Civ. arts. 485–504. If local mining laws prohibit divisibility of title or require that title be recorded in one name only,



- consider transferring the concession title to the foreign investor's local subsidiary. *See also* note 73 *infra*.
47. Venez. Cód. Civ. art. 765.
  48. Venez. Cód. Civ. art. 768; Guat. Cód. Civ. art. 493.
  49. This author (on the advice of local counsel) has used this structure to document an option/joint venture agreement in Guatemala. An option to purchase was not recommended because article 1,681 of the Guatemalan Civil Code limits the option period to only two years in the case of real property rights.
  50. Guat. Cód. Civ. art. 499.
  51. *See* Ossa, note 36 *supra*, at 298–299 (arguing that co-ownership is difficult to administer, and noting that article 173 of the Chilean Mining Code provides a superior quasi-contractual entity called *sociedad legal minera* or “legal mining company” that is deemed formed when two persons attempt to jointly stake a claim or when a partial interest is registered in a claim that was previously registered in the name of one person—e.g., as can occur upon the death of the owner of a concession who leaves (or is deemed to leave) his assets to his children in equal parts).
  52. The *consorcio* is, however, mentioned in art. 15(4) of the Guatemalan Civil Code.
  53. *See* Enrique Zaldivar et al., *Contratos de Colaboración Empresarial—Agrupaciones de Colaboración, Uniones Transitorias de Empresas, Joint Venture* (Arg. 2d ed. 1997) (hereinafter “Zaldivar”) at 177–178.
  54. Colom. *Ley 80 de 1993* (*Diario Oficial* No. 41.094 del 28 de octubre de 1993), *Estatuto General de Contratación de la Administración Pública*, art. 7(1)—*De los Consorcios y Uniones Temporales*. “7(1) *Consorcio*: Cuando dos o más personas en forma conjunta presentan una misma propuesta para la adjudicación, celebración y ejecución de un contrato, respondiendo solidariamente de todas y cada una de las obligaciones derivadas de la propuesta y del contrato. . . .”
  55. *Id.* *See also* Colom. *Ley de Minas* art. 17.
  56. *See* Arg. Law 19,500 arts. 377 et seq. For complete text and commentary, see Jorge Osvaldo Zunino, *Régimen de Sociedades Comerciales*, *Ley 19,550* (18th ed., 2003). *See also* Zaldivar, 171–238. For a model UTE form, as well as a discussion of the tax and accounting treatment of a UTE, see Televa Savat, *Como Hacer un Contrato de Colaboración Empresarial (Agrupación de Colaboración y Unión Transitoria de Empresas)* (3d ed. 2000).
  57. *Bajo de la Alumbraera*, currently the largest mining operation in Argentina (located in the Province of Catamarca), has adopted the UTE form. For a discussion of the basic elements of the UTE contract, see Daniel A. Bianchi, *General Comments on the Use of “Form 5” in Argentina*, Paper 3A, Rocky Mtn. Conference, Lima 2003. Bianchi notes that, in Argentina, Form 5 has been used as a checklist in drafting UTEs. Bianchi’s comment is evidence of the cross-pollination that is occurring with growing frequency as lawyers trained in the civil law countries of Latin America are exposed to contract forms developed by lawyers trained in the common law as a result of cross-border transactions. Because of differences in the two legal systems, contracts drafted by lawyers trained in the common law tend to be lengthy and detailed so as to anticipate every conceivable breach. By contrast, the Latin American lawyer generally prefers a shorter document reciting broad statements of principle, leaving gaps to be filled in by interpretation of the codes governing the subject matter. The common law legislative drafting technique of using extensive definitions is also making its way into the laws and decrees of Latin American countries.
  58. Law 19,550 art. 377. According to Zaldivar, note 53 *supra*, at 187, failure to register does not affect enforceability as between the parties, but results in a lack of constructive notice to third parties.
  59. Law 19,550 art. 378; Zaldivar, note 53 *supra*, at 197–211.
  60. *Id.* art. 381.
  61. *Id.* art. 380.
  62. Ecuador *Ley de Minería* No. 126, arts. 133–136.
  63. *Id.* art 135.
  64. *See* Zaldivar, note 53 *supra*.
  65. *See* *Ley 80*, note 54 *supra*: “7(2) *Unión temporal*: Cuando dos o más personas naturales o jurídicas presenten una misma propuesta para la adjudicación, celebración y ejecución del contrato, respondiendo solidariamente por el cumplimiento total de la propuesta y del objeto contratado”. [7(1) Temporary union: When two or more natural persons or legal entities jointly present the same bid for adjudication, entering into and execution of a contract, responding jointly and severally for the total performance of the bid and the object of the contract.]
  66. Colom. *Ley de Minas* art. 17.
  67. *See* Supreme Decree No. 22407 of 11 February 1990. *See also* Investment Law 1182 of 11 September 1990, ch. 5, recognizing joint ventures, and 1997 Mining Code ch. 4.
  68. *See* Peru *Ley General de Minería* (Supreme Decree 014-92-EM) arts. 204–205.
  69. A popular variation in Mexico and Honduras is the *sociedad anónima de capital variable* (variable capital corporation) or S.A. de CV. In those countries, the principal difference between the S.A. de C.V. and an S.A. is that Mexican and Honduran S.A.s must hold a shareholders’ meeting every time capital is increased, and in an S.A. de C.V. the directors may increase the capital up to an amount previously authorized by the shareholders. In Guatemala, the directors of an S.A. may increase issued capital up to the authorized limit set by the shareholders (Guat. Cód. Com. art. 88).
  70. Chile Cód. Min. arts. 200–205. Ossa, note 36 *supra*, at 327–333.
  71. *See* Cristián Quinzio S., Rocky Mtn. Conference, Lima 2003 (Paper 3, Chile, at 3–18).
  72. The form of articles in the Spanish language (or Portuguese, in the case of Brazil) should be attached as an exhibit to the shareholders agreement. Some countries require multiple shareholders (e.g., a minimum of seven is required in the Dominican Republic).
  73. The optionee might pay for its equity by contributing to the capital of the company some cash for initial working capital and (subject to valuation restrictions under local company law) any geological studies it has prepared during the option period. The optionor and owner of the mineral rights usually will be expected to pay for its equity by transferring legal and beneficial ownership of the concession title to the entity. If transfer of the concession title requires the approval of any government agency, then the optionor should covenant to use its best efforts to promptly obtain such approval and to grant leasehold, usufruct or trust beneficiary rights to the concessions and surface lands pending such approval and transfer.
  74. This might include an agenda for the organizational shareholders’ meeting following incorporation at which the first directors (if an S.A.) are elected, the carving out of decisions (such as a sale or mortgage of the mineral rights) that require a qualified or unanimous decision, and an agenda for the first directors’ meeting at which the officers are appointed and by-laws are adopted. In some countries (e.g., Venezuela), the by-laws are merged with the articles into one document called *documento constitutivo-estatutario*; in other countries (e.g., Nicaragua), they are separate documents.
  75. Subject to local thin-capital rules, tax planning and financing considerations may dictate that each advance of funds be con-

tributed part in equity and part by interest-bearing (and tax-deductible) debt in some agreed proportion (e.g., 30% equity and 70% debt). Care should be taken to ensure that a mechanism is in place to ensure the adjustment of interests upon default in contribution. Unlike in a contractual joint venture, where dilution can be accomplished by a formula (i.e., total contributions of the defaulting venturer divided by the total contributions of all venturers multiplied by 100), here ownership of shares must be transferred or new shares issued to the non-defaulting shareholder only. While issuing new shares may be preferable to avoid any undesirable tax consequences to the seller, care must be taken in drafting the articles to ensure that the non-defaulting shareholder, acting alone, can cause the necessary capital increase and stock subscription, notwithstanding any company law requirement for a 75% or other qualified majority quorum and vote. This is because in many countries an S.A. requires a shareholders meeting to increase capital every time shares are issued (*see note 69 supra*). If a transfer is required, consider having the stock transfer register (and any share certificates) delivered to a qualified trustee who has been

granted an irrevocable power of attorney (i.e., coupled with an interest in the grantee), along with instructions to effect the transfer upon the occurrence of specified events.

76. *See note 35 supra.*
77. In that way, if exchange controls are later imposed, it will be easier to prove the preexisting debt and capital investment in order to qualify to purchase dollars for loan repayment and capital repatriation.
78. For example, in some countries (e.g., Guatemala), location of a mineral property near a national border may require a specific kind of joint venture structure, perhaps involving a trust to hold the foreign investor's interest.

**Mr. Macdonald is President of Macdonald Consulting LLC of Miami, Florida, which advises on doing business in Latin America. He also serves as Vice President, Corporate Development & General Counsel of Everton Resources Inc.**

## ***International Law Practicum and New York International Law Review*** **Available on the Web**

[www.nysba.org/ilp](http://www.nysba.org/ilp)



http://www.

**Back issues of the *International Law Practicum* and *New York International Law Review* (2000-present) are available on the New York State Bar Association Web site.**

*Back issues are available at no charge to Section members only. You must be logged in as a member to access back issues. For questions, log-in help or to obtain your user name and password, e-mail [webmaster@nysba.org](mailto:webmaster@nysba.org) or call (518) 463-3200.*

### ***International Law Practicum and New York International Law Review Index***

For your convenience there is also a searchable index in pdf format.

To search, click "Find" (binoculars icon) on the Adobe tool bar, and type in search word or phrase. Click "Find Again" (binoculars with arrow icon) to continue search.



**NEW YORK STATE BAR ASSOCIATION COMMITTEES**  
**International Law and Practice Section**



**Great Opportunities for Involvement!**

The New York State Bar Association International Law and Practice Section Committees offer both the experienced and novice practitioners excellent ways to enhance their knowledge and expertise. Through Section activities members examine vital legal developments in international law. The Section sponsors continuing legal education programs and publishes the *International Law Practicum* and *New York International Law Review* to keep you informed on the latest updates in the area of international law.

International Law and Practice Section Committees are a valuable way for you to network with other attorneys from across the state and research issues and influence the laws that can affect your practice. Committees are also an outstanding way to achieve professional development and recognition. Your involvement is very much welcomed.

Please consider me for appointment to the committees as indicated below.

I wish to become a member of NYSBA's International Law and Practice Section. Please send me information.

**Committees**

- |   |  |
|---|--|
| <input type="checkbox"/> Asia Pacific Law   | <input type="checkbox"/> International Matrimonial Law   |
| <input type="checkbox"/> Central & Eastern European and Central Asian Law           | <input type="checkbox"/> International Privacy Law   |
| <input type="checkbox"/> Corporate Counsel  | <input type="checkbox"/> International Sales & Related Commercial Transactions                   |
| <input type="checkbox"/> Customs and International Trade                            | <input type="checkbox"/> International Transportation  |
| <input type="checkbox"/> Immigration and Nationality                                | <input type="checkbox"/> Multinational Reorganizations & Insolvencies                            |
| <input type="checkbox"/> Inter-American Law/Free Trade in the Americas              | <input type="checkbox"/> Publications  |
| <input type="checkbox"/> International Banking, Securities & Financial Transactions | <input type="checkbox"/> Public International & Comparative Law/Arms Control & National Security |
| <input type="checkbox"/> International Dispute Resolution                           | <input type="checkbox"/> Real Estate   |
| <input type="checkbox"/> International Employment Law                               | <input type="checkbox"/> Seasonal Meeting  |
| <input type="checkbox"/> International Environmental Law                            | <input type="checkbox"/> Tax Aspects of International Trade & Investment                         |
| <input type="checkbox"/> International Estate & Trust Law                           | <input type="checkbox"/> Trade Compliance  |
| <input type="checkbox"/> International Human Rights                                 | <input type="checkbox"/> United Nations & Other International Organizations                      |
| <input type="checkbox"/> International Intellectual Property Protection             | <input type="checkbox"/> U.S.-Canada Law   |
| <input type="checkbox"/> International Investment                                   | <input type="checkbox"/> Western European (EU) Law   |
| <input type="checkbox"/> International Litigation                                   | <input type="checkbox"/> Women's Interest Networking Group                                       |

Name \_\_\_\_\_

Office Address \_\_\_\_\_

Home Address \_\_\_\_\_

Office Phone No. \_\_\_\_\_ Office Fax \_\_\_\_\_ Home Phone No. \_\_\_\_\_

E-mail Address \_\_\_\_\_

**Please return this application to:**

**Membership Department**  
**New York State Bar Association**  
**One Elk Street**  
**Albany, NY 12207**  
**Telephone: 518 487-5577**  
**E-mail: membership@nysba.org**

# International Law and Practice Section— Executive Committee—Officers

Chair .....	Paul M. Frank (212 210-9540)
Chair-Elect.....	Robert J. Leo (212 949-7120)
Executive Vice-Chair.....	John F. Zulack (212 412-9550)
Vice-Chairs .....	Jonathan I. Blackman (212 225-2000)
	John E. Blyth (585 325-1710)
	Charles Corwin Coward (3491 586-0332)
	David W. Detjen (212 210-9416)
	Joyce M. Hansen (212 720-5024)
	Albert L. Jacobs, Jr. (212 848-1004)
	Allen E. Kaye (212 964-5858)
	Eduardo Ramos-Gomez (212 912-7610)
	Saul L. Sherman (631 537-5841)
Treasurer .....	Lawrence E. Shoenthal (212 375-6847)
Secretary .....	Marco A. Blanco (212 696-6128)
Delegate to House of Delegates .....	James P. Duffy, III (516 228-0500)

# Section Committee Chairs and Co-Chairs

Asia Pacific Law .....	Lawrence A. Darby, III (212 836-8235) Henry Tang (212 408-2586)	International Privacy Law .....	Nava Bat-Avraham (212 217-0088) Andre R. Jaglom (212 508-6740)
Central & Eastern European and Central Asian Law .....	Susanne C. Heubel (212 404-8722) Serhiy Hoshorvskyy (212 370-0447)	International Sales & Related Commercial Transactions .....	John P. McMahon (704 372-9148)
Corporate Counsel .....	Carole L. Basri (212 982-8243) Michael J. Pisani (212 858-9548)	International Transportation.....	William Hull Hagendorn (914 337-5861) Alfred E. Yudes, Jr. (212 922-2211)
Customs and International Trade .....	Stuart M. Rosen (212 310-8000)	Multinational Reorganizations & Insolvencies .....	Robert W. Dremluk (212 696-8861)
Immigration and Nationality.....	Jan H. Brown (212 397-2800)	Publications .....	Thomas Backen (212 210-9567) Prof. Charles Biblowit (718 990-6760) David W. Detjen (212 210-9416) Lester Nelson (212 983-1950)
Inter-American Law/ Free Trade in the Americas .....	Carlos E. Alfaro (212 698-1147) Oliver J. Armas (212 912-7627)	Public International & Comparative Law/ Arms Control & National Security .....	Prof. Charles Biblowit (718 990-6760) Ambassador Edward R. Finch, Jr. (212 327-0493)
International Banking, Securities & Financial Transactions.....	Joyce M. Hansen (212 720-5024) Eberhard H. Rohm (212 773-5771)	Real Estate .....	Thomas Joergens (212 284-4975)
International Dispute Resolution .....	Peter H. Woodin (212 527-9600)	Seasonal Meeting .....	Oliver J. Armas (212 912-7627)
International Employment Law.....	Aaron J. Schindel (212 969-3090)	Tax Aspects of International Trade & Investment .....	Marco A. Blanco (212 696-6128) Ewout Van Asbeck (31-20-541-4830)
International Entertainment Law.....	Gordon Esau (604 443-7105)	Trade Compliance .....	Timothy M. Ward (212 899-5560)
International Environmental Law .....	Mark F. Rosenberg (212 558-3647)	United Nations & Other International Organizations.....	Jeffrey C. Chancas (212 431-1300) Edward C. Mattes, Jr. (212 308-1600)
International Estate & Trust Law .....	Michael W. Galligan (212 841-0572)	U.S.-Canada Law .....	David M. Doubilet (416 865-4368)
International Human Rights .....	Arthur L. Galub (212 595-4598) Rachel Kaylie (212 406-7387)	Western European (EU) Law.....	Tomaso Cenci (212 424-9171)
International Intellectual Property Protection .....	Gerald J. Ferguson (212 589-4238) L. Donald Prutzman (212 355-4000)	Women's Interest Networking Group .....	Helena Tavares Erickson (212 949-6490) Meryl P. Sherwood (212 644-2343)
International Investment .....	Aureliano Gonzalez-Baz (+52 (55) 5279-3601) Lawrence E. Shoenthal (212 375-6847)	International Litigation.....	Thomas N. Pieper (212 912-8248)
International Matrimonial Law .....	Rita Wasserstein Warner (212 593-8000)		

# International Division—Chapter Chairs and Co-Chairs

Charles Corwin Coward (Co-Chair)  
Jorge Juan 6  
Madrid 28001 Spain  
(3491) 586-0332

Eduardo Ramos-Gomez (Co-Chair)  
Thacher Proffitt & Wood, LLP  
Two World Financial Center  
New York, NY 10281  
(212) 912-7610

## **Amsterdam**

Steven R. Shuit  
Allen & Overy  
Postbus 75440  
Amsterdam 1070AK  
Netherlands

## **Barcelona**

Jaime Malet  
Malet, Abogados Asociados  
Avda. Diagonal 490, Pral.  
Barcelona 08006  
Spain  
(34) 93 238-7711

## **Beijing**

Liu Chi  
Zhong Lun Law Firm  
Floor 12, Bldg. #1, China Merch. Tower  
No. 118 Jiangua Road  
Beijing 100022  
People's Republic of China  
(86-10) 6568-1188, x283

## **Brussels**

George L. Bustin  
Cleary Gottlieb Steen & Hamilton  
57 Rue De La Loi  
Brussels 1040 Belgium  
011-(322) 287-2000

## **Budapest**

Andre H. Friedman  
Nagy & Trocsanyi, LLP  
1114 Avenue of the Americas  
New York, NY 10036  
(212) 626-4202

## **Buenos Aires**

Juan Martin Arocena  
Allende & Brea  
Maipu 1300  
10th Floor  
Buenos Aires 1006 Argentina  
54-1-1-4318-9930

## **Cyprus**

Christodoulos G. Pelagias  
27 Gregory Afxentiou Avenue  
PO Box 40672  
Larnaca, 6306 Cyprus  
(357) 2465-4900

## **Dublin**

Eugene P. Fanning  
EP Fanning & Co.  
71 Ailsbury Road  
Ballsbridge  
Dublin 4 Ireland  
(353) 1219-5935

## **Frankfurt**

Dr. Rudolf Colle  
Oppenhoff & Raedler  
Mainzer Landstrasse 16  
Frankfurt 60325 Germany  
49-69-71003-440/442

## **Geneva**

Nicholas Pierard  
Borel & Barbey  
2 Rue De Jargonnant  
Case Postale 6045  
Geneva 1211 6 Switzerland  
4122-736-1136

## **Hong Kong**

George Ribeiro  
Vivien Chan & Co.  
One Exchange Sq., 15th Floor  
8 Connaught Place  
Central Hong Kong  
People's Republic of China  
(852) 2522-9183

## **Israel**

Mitchell C. Shelowitz  
Ceragon Networks Ltd.  
24 Raoul Wallenberg St.  
Tel Aviv 69719 Israel  
(9723) 766-6770

Eric S. Sherby  
Yigal Arnon & Co.  
1 Azrieli Center  
Tel Aviv 67021  
Israel  
(9723) 608-7887

## **London**

Randal J.C. Barker  
GE Mortgage Insurance Limited  
6 Agar Street  
London WC2N 4HR  
England  
442 075-991-514

Anne E. Moore-Williams  
310 The Whitehouse  
9 Belvedere Road  
London SE1 8YS  
England  
00-44-7802-756-776

## **Lugano**

Lucio Velo  
Velo & Associati  
Piazza Riforma #5  
6901 Lugano 1, Switzerland  
(4191) 924-0451

## **Luxembourg**

Alex Schmitt  
Bonn Schmitt & Steichen  
44 Rue De La Vallee  
L-2661 Luxembourg  
Germany  
011-352-45-5858

## **Madrid**

Calvin A. Hamilton  
Monereo, Meyer & Marinel-lo  
C/Bárbara De Braganza 11, 2<sup>o</sup>  
Madrid 28004 Spain  
(3491) 319-9686

Clifford J. Hendel  
Araoz & Rueda  
Castellana 164  
Madrid 28046 Spain  
(3491) 319-0233

**Manila**

Efren L. Cordero  
Suite 1902-A, West Tower  
Philippine Stock Exchange Ctr.  
Pasig City, Philippines  
(632) 631-1177

**Mexico City**

Aureliano Gonzalez-Baz  
Bryan Gonzalez et al.  
Seneca 425 Polanco  
D.F., 11560 Mexico  
52 (55) 5279-3601

**Milan**

Dr. Maurizio Codurri  
Frau & Partners  
Via C. Poerio 15  
Milano 20129 Italy

**Montreal**

Jacques Rajotte  
Martineau Fasken  
PO Box 242  
Montreal H4Z 1E9 QUE, Canada  
(514) 397-7400

**Panama**

Juan Francisco Pardini  
Pardini & Associates  
PO Box 9654, Zone 4  
Panama City, Panama  
(507) 223-7222

**Pakistan**

Mahnaz Malik  
Simmons & Simmons  
Citypoint  
One Ropemaker Street  
London EC2Y 9SS  
UK  
(44) 207-825-3627

**Rome**

Cesare Vento  
Gianni Origoni & Partners  
Via Delle Quattro Fontane, 20  
Rome 00184 Italy  
(0039) 06-478-751

**Santiago**

Francis Lackington  
Baeza, Larrain & Rozas  
Av. Apoquindo 3001  
Piso 13  
Santiago, 7550227 Chile  
(562) 335-7340

**São Paulo**

Pablo M. Bentes  
Miller & Chevalier  
655 Fifteenth Street N.W., Suite 900  
Washington, D.C. 20005  
(202) 626-6019

**Stockholm**

Carl-Olof Erik Bouveng  
Advokatfirman Lindahl HB  
Box 14240  
SE-104 40 Stockholm, Sweden  
(46) 670-5800

**Toronto**

David M. Doubilet  
Fasken Martineau DuMoulin, LLP  
Box 20, Toronto Dominion Ctr.  
Toronto M5K 1N6 Canada  
(416) 865-4368

**Vancouver**

Donald R. Bell  
Davis & Company  
2800 Park Place  
666 Burrard St.  
Vancouver V6C 2Z7 BC Canada  
(604) 643-2949

**Vienna**

Dr. Christoph Kerres  
Baker & McKenzie-Kerres & Diwok  
Schubertring 2  
A-1010 Vienna, Austria  
(431) 516-60-100

**Zurich**

Dr. Erich Peter Ruegg  
Schumacher Baur Hurlimann  
Oberstadtstrasse 7  
5400 Baden Switzerland  
41-56-200-0707

Martin E. Wiebecke  
Kohlrainstrasse 10  
Kusnacht  
Zurich, CH-8700 Switzerland  
41-01-914-2000

**Council of Licensed Legal  
Consultants**

Hernan Slemenson  
Marval O'Farrell & Mairal  
509 Madison Avenue  
Suite 506  
New York, NY 10022  
(212) 838-4641

# INTERNATIONAL LAW PRACTICUM

## Editorial Board

### Editor in Chief

David W. Detjen

### Executive Editors

Thomas Backen

David W. Detjen

The *Practicum* is a publication of the International Law and Practice Section of the New York State Bar Association. It is distributed free of charge to members of the Section.

The New York State Bar Association wishes to acknowledge the generous contribution of Mead Data Central, Inc. in donating access to the LEXIS®/ NEXIS® service for our use in the preparation of this publication.

© 2004 by the New York State Bar Association.

ISSN # 1041-3405



International Law and Practice Section  
New York State Bar Association  
One Elk Street  
Albany, NY 12207-1002

**ADDRESS SERVICE REQUESTED**

NON PROFIT ORG.  
U.S. POSTAGE  
**PAID**  
ALBANY, N.Y.  
PERMIT NO. 155