

# 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

### ARTICLES:

<b>Developments in Competition Law in the European Union and the United States: Harmony and Conflict</b> .....	3
<i>Hon. Pamela Jones Harbour</i>	
<b>Private Enforcement of Competition Law in the EU: Trials and Tribulations</b> .....	14
<i>Johan Ysewyn</i>	
<b>Jurisdictional Issues in International Cartel Cases: A Canadian Perspective</b> .....	21
<i>Donald B. Houston and Jeanne L. Pratt</i>	
<b>UK-US Extradition for Antitrust Offenses</b> .....	35
<i>Robert M. Osgood and Nathy J. Dunleavy</i>	
<b>Workers Abroad, Trouble at Home: Multinational Employers Face Growing Liability for Labor Violations of Overseas Suppliers</b> .....	40
<i>Aaron J. Schindel and Jeremy Mittman</i>	
<b>United States Patent Protection for Computer Software</b> .....	45
<i>L. Donald Prutzman</i>	
<b>Cross-Border M&amp;A in India</b> .....	53
<i>Vineet Aneja</i>	
<b>Public-Private Partnerships in Brazil: Opportunities and Risks for Investors</b> .....	58
<i>Andrew J. Dell’Olio</i>	
<b>Electronic Commerce and the New UNCITRAL Draft Convention</b> .....	66
<i>Anjanette H. Raymond</i>	

### COMMENTARY:

<b>M&amp;A in Argentina in the Last Decade: Boom, Crisis and Resurgence</b> .....	74
<i>Alberto Navarro</i>	
<b>Legal Translation Today: Toward a Healthier State of Reality</b> .....	80
<i>Steven M. Kahaner</i>	
<b>Practical Implications of the Diversity of Languages and Legal Cultures in International Practice</b> .....	84
<i>Frank G. Helman</i>	



# **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 3½" 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, in pdf format, 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.

# Developments in Competition Law in the European Union and the United States: Harmony and Conflict

By the Hon. Pamela Jones Harbour

## I. Introduction

I appreciate very much the opportunity to contribute to the *Practicum* and to share with its readers some thoughts regarding relations between the United States and Europe in the field of competition policy. My remarks reflect my own views and not necessarily those of the Federal Trade Commission or any of its other Commissioners.

The subtitle of this article is “Harmony and Conflict.” From my perspective as an FTC Commissioner and a former New York State enforcement official, there is far more harmony than conflict among U.S. and EU competition enforcers. Furthermore, while we cannot rule out future conflicts, I believe that the trend is towards even more convergence and harmony.

By the way, when I speak of U.S. enforcers, I include not only the FTC and DoJ’s Antitrust Division, but also our state attorneys general, who are fully empowered to enforce U.S. federal antitrust laws.<sup>1</sup> Likewise, when I speak of EU competition enforcers, I include not only the European Commission’s Competition Directorate General (DG COMP), but also the member state competition authorities, such as the U.K.’s Office of Fair Trading (OFT) and the Competition Commission here in London, which are similarly empowered to enforce EU competition policy.<sup>2</sup>

With that point in mind, let me take a moment to salute three enforcement colleagues in the U.K. with whom the FTC has worked closely to create and maintain harmonious relations. First, Paul Geroski, whose recent passing is a loss not only to the United Kingdom, but to the whole competition community. I would like to add my condolences to those expressed by my Chairman, Deborah Majoras, when she was in London in September 2005 to participate in the Competition and Consumer Day program. Second, Sir John Vickers, who recently concluded his tenure as Chair of the OFT, during which he contributed in numerous ways to transatlantic convergence in competition policy and enforcement and provided support and leadership to the International Competition Network (ICN). We are grateful for his intellectual contributions to the debates over competition policy as well as his support for cooperation among the agencies. And, third, John Fingleton, who has brought his intellect and energy from Ireland to the OFT. Like John Vickers, John Fingleton has also contributed to transatlantic convergence and to the

development of the ICN as an effective force for further convergence of competition policy around the world. We in the United States will miss Paul, but look forward to continued contributions from John Vickers and John Fingleton in their new roles.

The communication and cooperation that we in the United States have enjoyed in working with these three gentlemen and with their European competition enforcement colleagues, is in marked contrast to the relations that existed between the United States and Europe—and, in particular, the United Kingdom—just twenty years ago. The uranium cartel and Freddie Laker cases brought the United States and the United Kingdom into conflict over sovereignty, national interests, competition policy and the methods of its enforcement.<sup>3</sup> These conflicts were of a magnitude and intensity to reach the desks of Margaret Thatcher and Ronald Reagan. The situation was neatly summed up by Lord Wilberforce when, in the uranium cartel litigation, he stated that “[i]t is axiomatic that in antitrust matters the policy of one state may be to defend what it is the policy of another state to attack.”<sup>4</sup>

Even as recently as 1997, HM Foreign Office inquired why the FTC would review the Guinness/Grand Metropolitan merger—despite the fact that each company obtained substantial revenues from consumers in the United States.<sup>5</sup>

Fortunately, thanks to communication, cooperation, and convergence among competition policy enforcers, we no longer receive such inquiries from the British Foreign Office; on the contrary, the U.S. agencies regularly communicate with their foreign counterparts: DG COMP in Brussels, the OFT and the Competition Commission in London, the *Bundeskartellamt* in Bonn, as well as the other EU member state competition authorities, not to mention those in our immediate neighborhood (namely, Canada and Mexico) and the authorities in Australia and Asia (such as the Japanese and Koreans).<sup>6</sup> We are also engaged in dialogue with the Chinese concerning the development of their competition policies.<sup>7</sup> This communication and cooperation have led to coordination of dozens of multijurisdictional investigations over the past decade, usually with successful results, that is, enforcement decisions that are compatible and do not put parties under conflicting obligations. Therefore, and with all due respect to the late Lord Wilberforce, we strive to cast his axiom to the dustbin of history. Yet, we recognize the possibility of potential conflict.

These observations are reminders of those sources of conflict and describe what we in the competition enforcement community have done—and continue to do—to avoid conflict and minimize its effects.

## II. Sources of Conflict

### A. Overview

Competition policy enforcement does not occur in a vacuum. FTC Chairman, Deborah Majoras, observed this in remarks made in September 2005 before the Fordham Corporate Law Institute in New York. She stated the following:

The job of the antitrust enforcer is, of course, to apply the competition laws fairly and consistently, without regard to “political” interests, meaning partisan interests, as the term is generally used. In this sense, apolitical application is vital to maintaining the effectiveness of our competition laws, and to garnering public support for a culture of competition. This does not mean, however, that competition enforcers operate in a vacuum tube, isolated and immune from the political process. Far from it. The policies of and actions taken by antitrust enforcers can have a significant impact on elected policy-makers; and, similarly, the political actions produced by legislatures and regulatory agencies can have a significant impact on our work.<sup>8</sup>

As much as we who are responsible for enforcement would like to carry out competition policy on the merits for the protection of consumers, we must acknowledge that we are accountable to our governments. And, those governments may pursue other policies that may come into conflict with, and override, competition policy enforcement. Such conflicts can arise in purely domestic matters with no international aspects. The potential for conflict is magnified when business conduct or transactions have effects in more than one jurisdiction. To understand how competition enforcers try to avoid and minimize such conflicts, it is important to recall the sources of such conflict.

### B. Sovereignty

The sovereignty of nation states is a fundamental source of potential conflict that necessitates international cooperation for effective competition policy enforcement. Nations adopt competition policies and establish the agencies to enforce them for the benefit of their own consumers. They do not expect other nations to protect their consumers from anticompetitive harm. And, for reasons other than competition policy, they may be sus-

picious of other nations whose enforcement reaches beyond its borders. These are a couple of reasons why many speakers on this topic routinely say that they do not expect to see the creation of a single worldwide competition enforcement agency in our lifetimes.

Evidence of the importance of sovereignty is all around us. Defense of sovereignty was at the root of the United Kingdom’s objections in the uranium cartel and Freddie Laker cases to what it alleged was extraterritorial enforcement by the U.S. of its competition laws. Other more recent examples include the decisions of the U.K., Denmark and Sweden not to join the European Currency Union and to maintain their domestic currencies rather than replace them with the euro. In the field of competition policy, the efforts of Lord Brittan to create a “one-stop shop” for merger reviews in Brussels were constrained by the EU member states, as the Council of Ministers adopted a merger control regime that requires mergers of a “community dimension” to be notified to DG COMP in Brussels, while leaving all others to the twenty-five member state competition authorities.<sup>9</sup> The EC Merger Regulation<sup>10</sup> also provides that mergers of a community dimension having an impact on a distinct market of an EU member state may be referred to that member state for review. This division of authority reflects a concept based on sovereignty within the European Union: “subsidiarity,” a principle by which authority is allocated to the level of government closest and best placed to carry out the authority.<sup>11</sup>

Subsidiarity is an appropriate concept in competition policy enforcement, especially now that most enforcement regimes in the world make consumer welfare the goal of competition-policy enforcement. The agencies that are closest to the consumers affected by a business practice or transaction are likely to be best placed to evaluate those effects.

This notion may give heartburn to corporate executives who think globally of the efficiencies that may be realized by a merger of companies with facilities and customers in a number of countries but that may face review by several competition authorities. During the merger wave of the mid- to late-1990s, Professor Eleanor Fox of New York University Law School said enforcers needed “vision from the top,” looking beyond borders to recognize the benefits of globalization of business.<sup>12</sup> Through the communication and cooperation among enforcement agencies that evolved during that time (which are discussed below in Part III), the agencies showed that they had a “vision from the top.” But, they did not lose sight of the ground, down where the consumers are.

We may not hear complaints as often today as were heard twenty years ago about “extraterritorial” enforce-



ment. But, sovereignty is a fundamental factor in the relations among nations. In fact, the first of the ICN's Guiding Principles for Merger Notification and Review Procedures, adopted at its first annual meeting in September 2002, is a recognition of sovereignty.<sup>13</sup>

### C. National Interests

Sovereignty is often expressed in terms of national interests, such as industries deemed to be strategic and thus to be kept from foreign ownership. France has been in the news lately as some government ministers have claimed that Danone is a "national treasure" that must be protected from rabble such as Pepsico.<sup>14</sup>

While some may shake their heads at the French with some combination of dismay and humor, we all must take seriously national interest claims. France is not alone in providing statutory protection from foreign ownership to some industries. The United States maintains several such limitations—specifically, for example, as to airlines—and the Exon-Florio Act of 1988 gives the President the power to block acquisitions by foreign firms that would "threaten to impair the national security."<sup>15</sup> Recently, the bid by Chinese National Offshore Oil Company to acquire Unocal renewed attention to this law. It has prompted an effort by some in the U.S. Congress to provide even more scrutiny of such transactions.<sup>16</sup> And, in the U.K., the uranium cartel litigation mentioned above was a factor leading to enactment of the Protection of Trading Interests Act of 1980, one of the so-called "blocking statutes."<sup>17</sup>

Such claims of national interest, by the way, are not limited to concerns over foreign ownership; they can include sometimes vague "overriding public interests." For example, merger review in a number of EU member states, including the U.K.,<sup>18</sup> is subject to ultimate decision by a government minister acting under varying formulations of the public interest. For example, in Germany several years ago, the *Bundeskartellamt* decided to prohibit the proposed merger of E.on and Ruhrgas.<sup>19</sup> The parties, however, persuaded the German Economics Ministry to use the authority reserved to it in Germany's competition law to override the decision of the *Bundeskartellamt* and allow the merger to be consummated.<sup>20</sup>

### D. Regulatory Versus Market-Based Economic Policies

The extent to which governments regulate various industries can also override competition policy. This can take a number of forms and serve as an entry barrier. For example, pharmaceutical products and medical devices are typically subject to approval by national regulatory authorities. This is a fundamental reason why pharmaceutical mergers require separate analyses in each nation in which the companies' products are

approved for sale. Likewise, national pharmaceutical regulators may impose varying approval requirements, meaning that entry may take longer in one country than in another. That can affect the competition agencies' entry analysis and lead to different results.

Furthermore, the fact that some nations have been reluctant to liberalize various economic sectors and open them to competition can affect a potential competitor's efforts to enter a new market. The extent to which a nation has, in fact, liberalized a sector, such as telecommunications, may also affect a competition agency's analysis of the extent to which a former monopolist may be abusing a dominant position. Margaret Bloom, former Director of Competition Enforcement at the OFT, suggests in an illuminating article presented to the American Bar Association earlier this year, that European enforcers may be more likely to find abuse of dominance in such liberalizing sectors because currently dominant firms were previously state-controlled monopolies, and markets in Europe remain national in scope, leaving less chance for rivalry.<sup>21</sup>

### E. Different Aims of Competition Policy and Theories of Competitive Harm

A potential source of conflict among competition enforcers is the differences in competition policy; either as to its aims or its theories of competitive harm, or both. Many jurisdictions, including the United States with its Robinson-Patman Act,<sup>22</sup> have enacted anti-price discrimination laws with the aim of protecting small- and medium-sized enterprises against large businesses. Even competition laws that are facially neutral as to such aims may, however, be interpreted to protect "competitors rather than competition."

More specifically, some enforcers may pursue theories of competitive harm that others have found through experience rarely to be supportable with empirical evidence. For example, the EC Merger Regulation requires the EC to consider the "economic and financial power" of the merging parties.<sup>23</sup> The U.S. agencies no longer give this factor—referred to by some as the "deep pockets" theory—much, if any, weight.

### III. Evolution from Conflict to Cooperation to Convergence in Competition Policy

The factors discussed above are the main sources of conflict among nations and their competition enforcers. They have reared their heads in the past and they remain factors with which we may have to contend in the future.

Nevertheless, over the past generation, instances of conflict have declined. Instead, cooperation and coordination increasingly typify relations between nations and their competition enforcers. A consequence of that

cooperation and coordination has been convergence in competition policy. It should be noted that this has happened even as the number of competition enforcers has grown substantially.

This evolution from conflict to cooperation to convergence was stimulated within bilateral relationships and has been reinforced and expanded within multilateral relationships. It was also aided by evolving views of economic policy, especially as to the role of competition and open markets as drivers of economic development and growth. And, this evolution has served as a model for newer competition enforcement agencies to emulate, both in the adoption of sound policy and the enforcement of their laws.

A brief review of history is instructive. Conflicts between Canada and the United States over competition policy enforcement in the 1950s resulted in discussions between their respective attorneys general that led to commitments to notify and consult on such matters.

In 1967, the Organization for Cooperation and Economic Development (OECD), consisting at that time of the major Western industrial countries, agreed to a recommendation that its members notify one another of competition enforcement matters that would affect another member's important interests and that they would consult with each other and take each other's interests into consideration in making their enforcement decisions.<sup>24</sup>

Beginning in 1976, the United States entered a series of bilateral competition enforcement cooperation agreements aimed at avoiding conflict and fostering cooperation in enforcement. The 1976 Germany-U.S. Agreement stemmed from German-American relations that had developed during the post-World War II decartelization of the German economy and the enactment of Germany's competition law in 1957. The 1982 Australia-U.S. Agreement dealt with the problems that arose between them during the uranium cartel litigation referred to above.<sup>25</sup> Two years later, the United States and Canada came to a similar resolution. Then, in 1991, recognizing that they might come to blows over conflicting merger reviews, given enactment of the EC Merger Regulation, the United States and the European Communities entered into a cooperation agreement.<sup>26</sup> Before the ink was dry on that agreement, intensive contact began between the U.S. agencies and the EC's Competition Directorate. By the time the mid-90s merger wave began, they understood each other's laws and procedures and were committed to cooperation. Coincidentally, in a development that could only be fully appreciated now, a gentleman named Philip Lowe<sup>27</sup> served as Director of the EC's Merger Task Force (MTF) from 1993-95. Under his leadership, the MTF and the

U.S. agencies began to work together on the ever-growing case load of mergers and built the framework in which day-to-day U.S.-EC cooperation functions.

By 1997, the agencies had already established a record of numerous successful collaborations. The Boeing/McDonnell Douglas case<sup>28</sup> in that year illustrated how differences between competition laws can lead to different enforcement results. Although the FTC majority and the EC agreed that McDonnell Douglas no longer exerted competitive pressure in the commercial airliner market, their respective laws led them to different conclusions as to the competitive effects of the merger. The FTC found that the merger would not substantially lessen competition while the EC found that the merger would strengthen Boeing's dominant position. The EC agreed to consultations on the case and accepted remedies that would allow the merger to proceed. Some politicians in the United States complained about the result. But, neither the FTC nor the EC let the conflict affect their relations. A month after the Boeing decisions, it was agreed that FTC staff would attend the EC's hearing in the Guinness/Grand Metropolitan case and, shortly after that hearing, agreement was reached with the parties on a settlement that would resolve concerns in the same product market both in Europe and in the United States.<sup>29</sup>

Ironically, a few years later, another case involving Boeing would find the shoe on the other foot, but no one complained of "conflict." Boeing sought to acquire Hughes's satellite business. The FTC accepted a consent agreement, settling charges over the anticompetitive effects resulting from that vertical merger.<sup>30</sup> The EC and FTC fully cooperated with each other in the investigation and settlement of the case, aided by waivers of confidentiality granted by the merging parties. The EC, however, could not find that the merger would create or strengthen a dominant position in any relevant market, and therefore it could not condition clearance of the merger on the settlement terms.<sup>31</sup> The recent revision of the EC Merger Regulation's substantive standard, had it been in effect at that time, would have enabled the EC to avoid the dominance analysis of the old standard and to consider adoption of a finding, akin to the FTC's, that the merger would "significantly impede effective competition."

Around that time, in 1999, the U.S. agencies and the EC decided that the time had come to apply the knowledge they had gained in case cooperation to policy development. The FTC had issued its Divestiture Study,<sup>32</sup> and the EC thought it should issue guidance on merger remedies. Therefore, the EC and the U.S. federal agencies agreed to establish a Merger Working Group, and merger remedies would be the first issue for its consideration. As a result of its work, the EC issued merger remedies guidelines in 2001<sup>33</sup> that Mario Monti,

then EC Competition Commissioner, praised as a product of U.S.-EC collaboration.<sup>34</sup>

Unfortunately, the GE/Honeywell<sup>35</sup> case of 2001 resulted in an enforcement conflict involving differences in law and enforcement policy, some of which had been observed in the Boeing/McDonnell Douglas case. The EC and U.S. decided to task the Merger Working Group with assessing both substantive and procedural differences in their systems. One result of that effort was the issuance in 2002 of Best Practices on Cooperation in Merger Investigations, a statement that reflects in some detail the ways in which the agencies cooperate with one another and how parties can, if they wish, facilitate that process.<sup>36</sup> Another result of that effort was a more thorough understanding on both sides of the nature and extent of the differences between them in the fields of vertical and conglomerate mergers. This is discussed in more detail below.

In the meantime, cooperation and coordination has continued unabated and has expanded in some cases to tri- and multilateral cooperation involving Canadian, Mexican, and other competition authorities. As parties have gained a greater appreciation of the extent to which the agencies actually do communicate and cooperate, they have been more willing to facilitate cooperation, especially through the grant of waivers of confidentiality that principally allow the agencies' staffs to thoroughly discuss the parties' documentary submissions.

The following are some examples of recent cases whose resolution involved close cooperation between the FTC and the EC:

- **Sanofi/Aventis:** Sanofi-Synthelabo's 2004 acquisition of Aventis, S.A., raised competitive issues in several pharmaceutical markets. Close consultation and cooperation between FTC and EC staff were necessary, particularly to achieve non-conflicting remedies in the separate European and U.S. markets for cytotoxic drugs for the treatment of colorectal cancer. Complicating that effort was the existence of third-party rights in one of the jurisdictions, a factor that is quite common in the pharmaceutical industry. Because this was a tender offer subject to France's takeover code, the FTC also consulted with France's financial regulator, the AMF.
- **Sony/BMG:** The FTC and the EC communicated regularly in their respective investigations of this proposed merger of the parties' music businesses. Of particular concern was increasing concentration in the industry and rapidly evolving changes in the distribution of music. Both agencies ultimately closed their investigations without taking enforcement actions, acknowledging publicly

their close communication during the investigations.

- **Procter & Gamble/Gillette:** The FTC's press release on this matter noted cooperation among the FTC, the EC and other jurisdictions as well.

This experience, including the conflicts, teaches that we cannot underestimate the importance of bilateral relationships in fostering enforcement cooperation in case work as well as in the development of convergence in policy.

As indicated at the outset of this article, references in this article to EU enforcers include the EU member state authorities. Although most case coordination is with DG COMP, there are also numerous examples of successful collaboration with member state authorities. For example in 2002, the FTC worked closely with the UK's OFT and Competition Commission on the cruise lines cases and last year with OFT and the *Bundeskartellamt* in the GE/InVision case.<sup>37</sup> The U.S. agencies are fully cognizant of the role the member states play in EU competition enforcement, enjoy positive relations with them, and do whatever they can to further them.

These bilateral relationships have effectively merged and brought aboard many new colleagues in the competition enforcement community to form the International Competition Network (ICN). Launched in October 2001, the ICN provides a virtual venue for the world's competition agencies to deal with competition policy and enforcement issues.<sup>38</sup> It facilitates procedural and substantive convergence in antitrust enforcement through a results-oriented agenda and informal, project-driven organization. Its fourth annual conference in Bonn, Germany, in June 2005, was attended by over 400 people, representing more than eighty competition authorities and including nongovernmental advisors from the private sector and academia.

In its four years of existence, the ICN has, *inter alia*, developed a comprehensive set of recommended practices for merger notification and review procedures aimed at adoption of best practice notification requirements and review procedures. The ICN has also encouraged and monitored implementation of its recommended practices; in fact, over fifty percent of ICN members with merger review laws have made or planned revisions to their merger regimes that bring them into greater conformity with the recommended practices.<sup>39</sup> Such efforts will lead to convergence, making merger review easier for merger parties and enforcers alike.

#### **IV. U.S.-EU Competition Policy Harmony: Close, with Some Chords Yet to Be Resolved**

Despite the numerous cases of successful transatlantic enforcement cooperation, conflicts generate head-



lines declaring “splits” and “trade wars,” as occurred in the wake of the EC’s March 2004 decision in its case against Microsoft.<sup>40</sup> Reacting to that decision, Microsoft’s general counsel, Bradford L. Smith, said that the EC’s decision “shatters any notion that there is harmony in transatlantic competition decisions.”<sup>41</sup> Whether one sympathizes or not with Microsoft’s position in this case, Mr. Smith’s comment is contradicted by dozens of matters successfully resolved by U.S. and European authorities, involving issues of comparable economic weight and importance as those in the Microsoft cases. It is important to study those many cases to understand how cooperation “works” in practice, generally, and as to the resolution of specific issues in actual cases. With that background, this article will now address the extent of U.S.-EU convergence in the fields of cartels, mergers, and unilateral conduct.

### A. Cartels

Cartel enforcement in the United States—particularly that which results in criminal penalties, such as fines and imprisonment of those responsible for the cartel—is handled by the Antitrust Division of the Department of Justice (DoJ). DoJ has been a consistently tough cartel enforcer for decades. It has developed tools, such as leniency, that help to crack, reveal, and unravel cartels. The U.S. Congress has helped these efforts through a recent enactment that allows for higher penalties and other incentives to successfully terminate cartels.<sup>42</sup>

The EC, starting under the leadership a decade ago of Competition Commissioner Karel Van Miert and Director General Alexander Schaub, has elevated cartel enforcement to one of its highest priorities.<sup>43</sup> The EC adopted a leniency program in 1996, but with experience, Commissioner Mario Monti modified it in 2002 to converge and cooperate with DoJ’s leniency program.<sup>44</sup> The recent establishment of a separate cartel enforcement directorate in DG COMP demonstrates Commissioner Neelie Kroes’s commitment to maintaining cartel enforcement as a high priority. The convergence in enforcement policy has been matched by cooperation in investigations. Joint, coordinated dawn raids have taken place and other efforts have been taken to further cooperation in investigations and prosecutions.

### B. Mergers

The field of mergers also enjoyed convergence in policy that has made the long-standing cooperation between the EC and U.S. authorities easier to carry out, particularly as to horizontal mergers that account for most merger cases. The reform of the EC Merger Regulation that took effect last year included revision of the substantive standard for the review of mergers that effectively harmonized it with the merger review standard contained in the U.S. Clayton Act. The EC’s Horizontal Merger Guidelines<sup>45</sup> in most respects include the

same elements and track the analytical approach taken under the 1992 DoJ-FTC Horizontal Merger Guidelines.<sup>46</sup> Furthermore, the introduction of the Chief Economist and his team has had a positive impact not only on DG COMP, but also in our cooperation on cases.

Some changes in the procedure under the EC Merger Regulation—particularly the changes in counting the days toward decision deadlines and the possibility to “stop the clock”—benefit not only the merging parties and DG COMP, but also their efforts to coordinate the procedure with other enforcement authorities’ investigations.

Another change made as part of the EU merger reform effort deserves more attention than it has received to date, namely, the re-wording of Section 5.4 of the EC’s premerger notification form, Form CO. It now tracks very closely the language in Item 4(c) of the U.S. Hart-Scott-Rodino premerger notification form. It appears that, as Form CO, Section 5.4 now reads, merging parties obligated to notify both the EC and U.S. agencies must give the EC at least the same documents they give the U.S. agencies under Item 4(c) and, perhaps, more. These are the internal company documents that were prepared for officers or directors for the purpose of analyzing the proposed transaction.<sup>47</sup>

We should also keep in mind other examples of convergence that were already in place and have not changed: specifically, the EC’s 1997 market definition guidelines<sup>48</sup> and its 2001 merger remedies guidelines.<sup>49</sup>

But, some substantive differences remain. In that regard, what was *not* changed in the Merger Regulation is notable, as are European court decisions. For example, the Merger Regulation obliges the EC to consider a number of factors in analyzing the competition effects of a merger, including the “economic and financial power” of the merging parties. As mentioned above, this factor is sometimes dismissively called the “deep pockets” theory, one that American enforcers are unlikely to find persuasive. But, calling it names does not make it go away. Even if the EC were inclined to give it less weight, it cannot ignore this factor, as it learned to its chagrin a few years ago when one of its decisions to clear a merger in the German coal industry was overturned because the court found that the EC had failed to consider that factor.<sup>50</sup> Furthermore, those same European courts have endorsed “leveraging”<sup>51</sup> and “portfolio power”<sup>52</sup> theories that are viewed more skeptically by some enforcers in the United States.<sup>53</sup> The issue of “bundling” appears to remain open after the decision of the Court of First Instance affirming the EC’s GE/Honeywell decision.<sup>54</sup>

The foregoing must be kept in perspective. Relatively few merger cases raise vertical or conglomerate



issues and few of those lead to enforcement actions. But, some of those issues also arise in the context of inquiries over the behavior of dominant firms, and that is an area of remaining divergence between the EC and the United States.

### C. Unilateral Conduct

The *Microsoft*<sup>55</sup> case is but one recent example that illustrates differences between the U.S. and EC in dealing with unilateral conduct cases. *British Airways*,<sup>56</sup> a case dealing with fidelity rebates is another. Margaret Bloom's article, noted above, neatly describes the differences over this issue that are displayed by the contrasting U.S. and EU judicial decisions in the *British Airways* case.<sup>57</sup> The European court viewed the rebates at issue as suspicious while the American court viewed them as pro-competitive.

She also notes that the law of monopolization in the United States is somewhat unsettled, given the recent Third Circuit Court of Appeals decision in *Lepage's, Inc. v. 3M*.<sup>58</sup> In this regard, she states the following:

While U.S. law is clear on the procompetitive benefits for consumers of above cost single product rebates, this is not so for multi-product or bundled rebates. For example, in *LePage's v. 3M*, the Third Circuit ruled that 3M's bundled rebate program violated Section 2 despite the fact that the prices, even after the rebates, do not appear to have been below cost. . . . The opinion reflected a concern over unfairness when a big multi-product firm exploits its advantages to the detriment of a smaller rival—a concern that would be more familiar in Europe.<sup>59</sup>

And, as mentioned above, Ms. Bloom observes that, while some markets in Europe may have been liberalized, they remain dominated by the former state monopoly. As she notes, "many of the big firms were previously state monopolies . . . [that] have not obtained their powerful positions through superior business performance—in contrast to most large U.S. firms."<sup>60</sup> This, to her, may suggest the need for more interventionist enforcement.

DG COMP is in the midst of a review of its enforcement policy in this area. It has commissioned a study by economists to advise on policy options,<sup>61</sup> and it is currently consulting with the EU member states on policy options in the area of exclusionary conduct. Commissioner Kroes spoke about the review at the recent Fordham conference in New York, expressing the anticipation of a wide-ranging public discussion of these issues.<sup>62</sup>

## V. Enforcement Cooperation in Practice

As can be seen from the foregoing discussion, some differences in competition law and enforcement policy remain in the transatlantic realm. But, differences have not prevented EU and U.S. authorities from effectively cooperating with one another in cases of concurrent jurisdiction. The narrowing of differences in the fields of cartel and horizontal merger enforcement should make cooperation easier in such cases. It should also make us optimistic over the prospect of further convergence.

The EC and the United States recognized when they entered their cooperation agreement in 1991 that the differences in their laws could lead to conflicting results in concurrently reviewed cases. That was the main reason they entered into the agreement; its stated purpose is to "lessen the possibility or impact of differences between the Parties in the application of their competition laws."<sup>63</sup>

The agreement contains several mechanisms designed to help the agencies fulfill that purpose; among them are commitments to notify, share information, consult, and to take each other's important interests into account in their decisions. With these elements, the agreement reflects the concept of comity among sovereigns. Comity is the Golden Rule principle applied to sovereigns: do unto others as you would have them do to you. Given the complexity of the matters the enforcers face, especially in terms of the frequently different effects a transaction or conduct may have in different jurisdictions, comity does not mean that one enforcer simply stands aside; instead it means that they work together, sharing information about the competition effects of the matter under scrutiny in their respective jurisdictions, identifying and clarifying their enforcement interests, and working together to identify an appropriate remedy. Comity is at the heart of the U.S.-EC Agreement and the agencies practice comity as a matter of course.

Cooperation among the enforcement agencies has become routine over the past decade, and it increasingly involves mutual cooperation involving the merging and third parties in the investigation and resolution of cases.<sup>64</sup> It was not always so, as a little review of history reveals.

Going into their agreement over a decade ago, U.S. and EC authorities recognized that their respective competition laws contained seemingly different legal standards. Efforts were undertaken to understand each other's laws and processes. Workshops were held in which EC and U.S. staff discussed analytical tools (market definition and competitive effects analysis, particularly under the then-new U.S. horizontal merger guidelines) and investigative methods (interview techniques

and document gathering and analysis). A study was made of each other's pre-merger notification instruments to learn precisely what information each side sought and gathered.

With the help of their respective legal services, the agencies also determined what kinds of information they could share with each other within the bounds of their respective confidentiality rules. The agencies distinguish confidential *agency* information that can be shared with other antitrust authorities from confidential *business* information, the disclosure of which is specifically barred by statute, absent a waiver from the submitter of the information.<sup>65</sup> Confidential *agency* information is information that the agencies are not prohibited from disclosing, but normally treat as non-public. This includes how the staff analyzes the case, including product and geographic market definitions, assessment of competitive effects, and potential remedies.

By the time merger activity started to grow in the mid-1990s, the agencies were ready not only to cooperate with one another, but also to coordinate their respective investigations. But, merging parties and their advisers were not. In some early cases, parties focused their attention on reaching a satisfactory decision in Brussels—within the unwaivable time deadline for a decision—and then turned to Washington, hoping that the U.S. authorities would accept the settlement negotiated in Brussels.<sup>66</sup> But, the agencies were prepared for this, having thoroughly communicated their respective analyses and conclusions to each other and determining what action, if any, should be taken.

As companies and their counselors became more familiar with the nature and extent of enforcement cooperation that took place among the agencies and recognized the benefits of coordination, they became more willing to facilitate the process. One substantial contribution that parties can—and now regularly do—make is to grant the agencies a waiver of their confidentiality rights over the information they submit to the agencies. Such waivers typically cover all materials submitted to the agencies but the waiver is limited to communication between the reviewing agencies. Confidentiality of all materials is maintained against third parties and the general public. Waivers have permitted the reviewing agencies to focus more quickly on those enforcement issues in which they have common concerns, determine whether the concerns are of a magnitude to require enforcement action by one or both agencies, and then consider remedial measures that would satisfy their concerns without subjecting the parties to conflicting obligations.<sup>67</sup>

Cooperation and coordination among the agencies and the parties have resulted in a lengthy record of

cases in which the U.S. agencies and the EC or EU member state authorities have arrived at the same results in their parallel review of cross-border mergers. It is beyond the scope of this paper to go into detail on many of the mergers involving cooperation between and concurrent investigations by U.S. and European officials. One need only consider the mergers in the pharmaceutical industry. Old names in that industry such as Wellcome, Hoechst, Upjohn, and Rhone-Poulenc were swept away in the merger wave. One might also think of the mergers in the auto parts and the oil and chemical industries. BP still exists, but Turner & Norall (T&N) does not. This is a small sample, and these companies all have one thing in common: their mergers were reviewed concurrently by the European and U.S. authorities, and settlements of their anticompetitive effects were achieved without conflict, allowing the parties to merge.

In the field of competition policy, U.S. and European authorities have established a cooperative model that has spread to other nations through, among other institutions, the ICN, and, potentially, to other fields of public policy. The *Financial Times* has observed the following:

The growth of US-EU co-operation on antitrust policy shows different methods can co-exist, provided objectives are broadly shared—or at least understood—and agencies do not retreat into territorial defensiveness.<sup>68</sup>

## VI. Conclusion

U.S. and EU competition authorities have faced, and continue to face, numerous hurdles to effective cooperation in enforcement and policy convergence. Some of the hurdles stand for efforts to defend sovereign interests. Others reflect different economic or regulatory policies. And, finally, some are differences in competition policies. Each of these hurdles has the potential to trip up the competition enforcers and cause them to crash into conflict.

The competition authorities on both sides of the Atlantic, however, recognize the benefits to their respective consumers of transatlantic investment and trade.<sup>69</sup> Accordingly, while they are watchful for anticompetitive effects of transactions and conduct, they can recognize the pro-competitive aspects as well. Ever conscious of their differences, they seek to fulfill the purpose of their cooperation agreement and “lessen the possibility or impact of [those] differences.”<sup>70</sup>

There is, indeed, far more harmony than conflict. The relationship is harmonious, but like any musical group, they need to practice and not rest on their laurels.

## Endnotes

1. The statutory bases of state authority to enforce U.S. federal antitrust laws are contained in Section 4C-4H of the Clayton Act, 15 U.S.C. §§ 15c-15h.
2. Council Regulation 1/2003, art. 5, On the Implementation of Rules on Competition Laid Down in Articles 81 and 82 of the Treaty, 2003 O.J. (L 001) 1 (EC) (4 Jan. 2003), available at <http://europa.eu.int/eur-lex/lex/JOHtml.do?uri=OJ:L:2003:001:SOM:EN:HTML> (hyperlink; last visited on 1 Feb. 2006).
3. See Spencer Weber Waller, *ANTITRUST AND AMERICAN BUSINESS ABROAD* (3rd ed. 1997) at § 6.14 (providing a synopsis of the uranium cartel litigation).
4. *Rio Tinto Zinc Corp. v. Westinghouse Electric Corp.*, [1978] A.C. 547, 617 (H.L.).
5. According to the FTC's complaint in that case (¶¶ 3 and 8, respectively), Guinness's U.S. revenues in 1996 were \$645 million, about 8 percent of its worldwide revenues of \$8 billion, and Grand Metropolitan's U.S. revenues in 1996 were \$8 billion, about 57 percent of its worldwide revenues of \$14 billion. The FTC's complaint, Docket No. C-3801 (issued 17 Apr. 1998), available at <http://www.ftc.gov/os/1998/04/9710081.cmp.htm>.
6. United States bilateral cooperation agreements with Australia, Brazil, Canada, the European Communities, Germany, Israel, Japan, and Mexico are available at <http://www.ftc.gov/bc/international/coopagree.htm>.
7. See "The Development of Antitrust in China, Korea and Japan," remarks by Deirdre Shanahan, FTC Bureau of Competition Counsel for Asia-Pacific Affairs, before the Conference on International Competition Law: Real World Issues and Strategies for Success, 16-17 June 2005, in Montreal, Canada, available at [http://www.ftc.gov/bc/international/docs/shanahan\\_montreal.pdf](http://www.ftc.gov/bc/international/docs/shanahan_montreal.pdf).
8. Remarks of Chairman Deborah P. Majoras before the 32nd Fordham Corporate Law Institute, N.Y., 22 Sept. 2005 (forthcoming).
9. Council Regulation 139/2004, On the Control of Concentrations Between Undertakings, 2004 O.J. (L 24) 1 (EC) (29 Jan. 2004,) (hereafter the "EC Merger Regulation") available at <http://europa.eu.int/eur-lex/lex/JOHtml.do?uri=OJ:L:2004:024:SOM:EN:HTML> (hyperlink; last visited 1 Feb. 2006).
10. *Id.*
11. See Article 5 of the Consolidated Version of the Treaty Establishing the European Community, 2002 O.J. (C 325) 1, at 33 (24 Dec. 2002), available at [http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/c\\_325/c\\_32520021224en00010184.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/c_325/c_32520021224en00010184.pdf).
12. See, e.g., Eleanor M. Fox, *Antitrust and Regulatory Federalism: Races Up, Down and Sideways*, 75 N.Y.U. L. Rev. 1781, 1803 (Dec. 2000), available at <http://scholar.google.com/scholar?hl=en&lr=&q=cache:WpoOxIhri4J:www.nyu.edu/pages/lawreview/75/6/fox.pdf+author:%22Fox%22+intitle:%22Antitrust+and+Regulatory+Federalism:+Races+Up,+Down,+and+Sideways%22>.
13. ICN Guiding Principles, available at <http://www.internationalcompetitionnetwork.org/icnnpguidingprin.htm>.
14. For a discussion of such efforts by EU member states, see *The Agenda for Europe - Economy and Competitiveness*, remarks by Commissioner Charlie McCreevy, Internal Market Commissioner, SPEECH/05/479 (3 Sept. 2005), available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/479&format=HTML&aged=0&language=EN&guiLanguage=en>. See also George Parker and John Thornhill, *France Reminded of Takeover Laws*, *Fin. Times*, 30 Aug. 2005, at 7.
15. Section 5021 of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107 (1988), amending Title VII of the Defense Production Act of 1950, 50 U.S.C. App. § 2158 *et seq.*, adding a new Section 721, granting authority to the President to review certain mergers, acquisitions, and takeovers by foreign persons.
16. See H.R. 3057, § 6130, as adopted by the U.S. Senate, 20 July 2005, available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109\\_cong\\_bills&docid=f:h3057eas.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_bills&docid=f:h3057eas.txt.pdf). The measure remains pending further action by the U.S. Congress.
17. For a description of blocking statutes see Spencer Weber Waller, 1 *ANTITRUST AND AMERICAN BUSINESS ABROAD* § 4.16 (3d ed. 1997).
18. See *Mergers—Procedural Guidance*, ch. 8, concerning "Public Interest Mergers" under the Enterprise Act 2002 (U.K. Office of Fair Trading Pub. OFT 526).
19. The story of the E.on/Ruhrgas gas is described by Germany's Federal Cartel Office, the Bundeskartellamt, in its annual report on competition policy enforcement for 2001-2002 to the OECD, at ¶¶ 59-68, available at <http://www.oecd.org/dataoecd/34/6/2489057.pdf>.
20. The story of the German Economics Minister's authorization of the E.on/Ruhrgas merger, overriding the decision of the Bundeskartellamt to prohibit it, is contained in the annual report of the Bundeskartellamt on competition policy enforcement for 2002-2003 to the Organization for Economic Co-operation and Development (OECD) (16 Feb. 2004) at ¶¶ 55-58, available at <http://www.oecd.org/dataoecd/22/21/34831942.pdf>.
21. Margaret Bloom, *The U.S. and EU Move Towards Substantial Antitrust Convergence on Consumer Welfare Based Enforcement*, 19 *ANTITRUST* 18, 22 (Summer 2005).
22. Act of 19 June 1936, ch. 592, 49 Stat. 1526 (codified at 15 U.S.C. §§ 13, 13b, and 21a).
23. EC Merger Regulation, *supra*, note 9, art. 2.1.(b.).
24. OECD, Revised Recommendation of the Council Concerning Co-operation Between Member Countries on Anticompetitive Practices Affecting International Trade, C(95)130/FINAL (1995), available at [http://webdomino1.oecd.org/horizontal/oecdacts.nsf/linkto/C\(95\)130](http://webdomino1.oecd.org/horizontal/oecdacts.nsf/linkto/C(95)130) (last visited on 1 Feb. 2006).
25. See Part I, at notes 3-4, *supra*.
26. European Communities–United States: Agreement on the Application of their Competition Laws, 23 Sept. 1991, 30 *INT'L LEGAL MATERIALS* 1487, 1492, reprinted in 4 *TRADE REG. RPT. (CCH)* ¶ 13,504 (hereinafter "U.S.-EC Agreement"), available at <http://www.usdoj.gov/atr/public/international/docs/ec.htm>.
27. Mr. Lowe is currently Director General of the European Commission's DG COMP.
28. *The Boeing Co.*, et al., Joint Statement closing investigation of the proposed merger and separate statement of Commissioner Mary L. Azcuenaga, FTC File No. 971-0051, 1 July 1997, reported in 5 *TRADE REG. RPT. (CCH)* ¶ 24,295, available at <http://www.ftc.gov/opa/1997/07/boeing.htm>; *Boeing/McDonnell Douglas*, Case No IV/M.877, European Commission Decision of 30 July 1997, O.J. (L 336) 16 (8 Dec. 1997), available at [http://europa.eu.int/comm/competition/mergers/cases/decisions/m877\\_19970730\\_600\\_en.pdf](http://europa.eu.int/comm/competition/mergers/cases/decisions/m877_19970730_600_en.pdf).
29. *Guinness/Grand Metropolitan*, Case No IV/M.938, Commission Decision of 15 Oct. 1997, 1998 O.J. (L 288) 24, available at [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=31998D0602](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=31998D0602); *In re Guinness PLC*, FTC File No. 971 0081, FTC Docket No. C-3801, Decision and Order, Apr. 17, 1998, reported in 5 *Trade Reg. Rpt. (CCH)* ¶ 24,359, available at <http://www.ftc.gov/os/caselist/c3801.htm>.
30. *In re Boeing Company*, FTC File No. 001 0092, FTC Docket No. C-3992, Decision and Order of 27 Sept. 2000, available at <http://www.ftc.gov/os/caselist/c3992.htm>.



31. *Boeing/Hughes*, Case No. COMP/M.1879, Commission Decision of 27 Sept. 2000, 2004 O.J. (L 063) 53 (28 Feb. 2004), available at [http://europa.eu.int/comm/competition/mergers/cases/decisions/m1879\\_en.pdf](http://europa.eu.int/comm/competition/mergers/cases/decisions/m1879_en.pdf).
32. Staff of FTC Bureau of Competition, *A Study of the Commission's Divestiture Process* (1999), available at <http://www.ftc.gov/os/1999/08/divestiture.pdf>.
33. Commission Notice on remedies acceptable under the [EC Merger Regulation], 2001 O.J. (C 68) 3 (2 Mar. 2001), available at <http://europa.eu.int/eur-lex/lex/JOHtml.do?uri=OJ:C:2001:068:SOM:EN:HTML> (hyperlink; last visited on 1 Feb. 2006).
34. Mario Monti, The Commission Notice on Merger Remedies— one year after CERNA, 18 Jan. 2002, SPEECH/02/10, available at [http://europa.eu.int/rapid/start/cgi/guesten.ksh?p\\_action.gettxt=gt&doc=SPEECH/02/10|0|RAPID&lg=EN](http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/02/10|0|RAPID&lg=EN).
35. Commission Decision of 3 July 2001 declaring a concentration to be incompatible with the common market and the EA Agreement (General Electric/Honeywell), Case No. COMP/M2220, 2004 O.J. (L 48) 1 (18 Feb. 2004), available at [http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220\\_en.pdf](http://europa.eu.int/comm/competition/mergers/cases/decisions/m2220_en.pdf) (last visited on 1 Feb. 2006).
36. U.S.-EU Merger Working Group, Best Practices on Cooperation in Merger Investigations (2002), available at <http://www.ftc.gov/opa/2002/10/euguidelines.htm>. (hyperlink; last visited on 1 Feb. 2006).
37. *In re General Electric Co.*, FTC File No. 041-0106, FTC Docket No. C-4119; decision and related materials available at <http://www.ftc.gov/os/caselist/0410106/0410106.htm>. *General Electric Co. and InVision Technologies*, B7 - 65/04, *Bundeskartellamt Decision of 17 Aug. 2004*, available (only in German) at <http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion04/B7-65-04.pdf>; "Clearance of General Electric / InVision Merger in Close Cooperation with US Competition Authority," *Bundeskartellamt press release* (in English), available at [http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2004/2004\\_08\\_19.shtml](http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2004/2004_08_19.shtml).
38. The ICN's Web site can be found at <http://www.internationalcompetitionnetwork.org/index.html>.
39. See Elizabeth F. Kraus and Maria B. Coppola, *International Competition Network - Update*, V THE THRESHOLD 2, 3 (Summer 2005), available at <http://www.ftc.gov/bc/international/docs/krauscoppolaicn05.pdf>.
40. Case COMP/C-3/37.792, COM(2004) 900 final (24 Mar. 2004).
41. Jonathan Krim, *Regulators, Rival React; EU's Microsoft Decision Shows Split with U.S.*, WASH. POST, 25 Mar. 2004, at E1.
42. Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. 108-237, 118 Stat. 665 (2004); see Statement of Assistant Attorney General for Antitrust, R. Hewitt Pate, on its enactment, available at [http://www.usdoj.gov/atr/public/press\\_releases/2004/204319.pdf](http://www.usdoj.gov/atr/public/press_releases/2004/204319.pdf).
43. See remarks of Alexander Schaub, then-Director General of DG-IV, 1999 FORDHAM CORP. L. INST.: INTERNATIONAL ANTITRUST LAW & POLICY at 68-69 (Juris Publishing).
44. European Commission Notice on immunity from fines and reduction of fines in cartel cases, 2002 O.J. (C 45) 3 (19 Feb. 2002), available at <http://europa.eu.int/comm/competition/antitrust/leniency>. See also, Mario Monti, EU Competition Policy, 2002 FORDHAM CORP. L. INST.: INTERNATIONAL ANTITRUST LAW & POLICY 87, 91 (Juris Publishing 2003) ("[US and EC] leniency programmes, . . . are now very similar. In fact, we paid a lot of attention to the success of the U.S. corporate leniency program when we drafted our new guidelines on leniency.")
45. Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings, 2004 O.J. (C 31) 5 (5 Feb. 2004), available at <http://europa.eu.int/eur-lex/lex/JOHtml.do?uri=OJ:C:2004:031:SOM:EN:HTML> (hyperlink; last visited on 1 Feb. 2006).
46. U.S. Department of Justice and FTC, Horizontal Merger Guidelines, issued 2 Apr. 1992, revised 8 Apr. 1992, reprinted in 4 Trade Reg. Rpt. (CCH) ¶ 13,104, available at <http://www.ftc.gov/bc/docs/horizmer.htm>.
47. The importance of such documents in the initial phase of merger review was described by Marian Bruno, Director of the FTC's Premerger Notification Office, in remarks entitled "Hart-Scott-Rodino at 25," before the American Bar Association conference, "Mergers and Acquisitions: Getting Your Deal Through the New Antitrust Climate," New York City, 13 June 2002, available at <http://www.ftc.gov/speeches/other/brunohsr25.htm>.
48. Commission Notice on the definition of the relevant market for the purposes of Community competition law, 1997 O.J. (C 372) 5 (9 Dec. 1997), available at [http://europa.eu.int/comm/competition/antitrust/relevma\\_en.html](http://europa.eu.int/comm/competition/antitrust/relevma_en.html).
49. Commission Notice on remedies acceptable under the [EC Merger Regulation], 2001 O.J. (C 68) 3 (2 Mar. 2001), available at [http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c\\_068/c\\_06820010302en00030011.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c_068/c_06820010302en00030011.pdf) (last visited on 1 Feb. 2006).
50. Case T-156-98, *RJB Mining PLC v. Commission*, 2001 E.C.R. II-337 (31 Jan. 2001), available at [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61998A0156](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61998A0156).
51. Case T-5/02, *Tetra Laval BV v. Commission*, Judgment of the Court of First Instance (First Chamber), 25 Oct. 2002, ¶¶ 151-152, available at [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0005](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0005).
52. Cases T-114/02 and T-119/02, *BaByliss SA v. Commission and Royal Philips Electronics NV v. Commission*, respectively, Judgments of the Court of First Instance, 3 Apr. 2003, available respectively at [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0114](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0114), [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0119](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=62002A0119).
53. See, e.g., Merger Enforcement in a World of Multiple Arbiters, Prepared Remarks of Timothy J. Muris, Chairman, Federal Trade Commission, before the Brookings Institution Roundtable on Trade and Investment Policy, Washington, DC, 21 Dec. 2001, at 7-8, available at <http://www.ftc.gov/speeches/muris/brookings.pdf>. See also *GE-Honeywell: The U.S. Decision*, remarks of Deborah Platt Majoras, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, before the Antitrust Law Section, State Bar of Georgia, 29 Nov. 2001, available at <http://www.usdoj.gov/atr/public/speeches/9893.pdf>.
54. Case T-209/01 and Case T-210-01, *Honeywell v. Commission and General Electric v. Commission*, respectively, 14 Dec. 2005, available at <http://curia.eu.int/en/content/juris/index.htm> (hyperlink "since 1989").
55. Case COMP/C-3/37.792, COM(2004) 900 final (24 Mar. 2004).
56. Commission Decision of 14 July 1999 relating to a proceeding under Article 82 of the EC Treaty (*Virgin/British Airways*), 2000 O.J. (L30) 1 (4 Feb. 2000).
57. Margaret Bloom, note 21 *supra*, at 22.
58. 324 F.3d 141 (3rd Cir. 2003), *cert. denied*, 542 U.S. 953, 124 S. Ct. 2932, 159 L. Ed. 2d 835 (2004).
59. Margaret Bloom, note 21 *supra*, at 22.
60. *Id.*



61. Report by the EAGCP, An Economic Approach to Article 82, July 2005, available at [http://europa.eu.int/comm/competition/publications/studies/eagcp\\_july\\_21\\_05.pdf](http://europa.eu.int/comm/competition/publications/studies/eagcp_july_21_05.pdf).
62. Preliminary Thoughts on Policy Review of Article 82, remarks by Commissioner Neelie Kroes before the Fordham Corporate Law Institute, N.Y., 23 Sept. 2005. See also DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses (Brussels 19 Dec. 2005). Both Commissioner Kroes's speech and the Discussion Paper are available at [http://europa.eu.int/comm/competition/antitrust/others/article\\_82\\_review.html](http://europa.eu.int/comm/competition/antitrust/others/article_82_review.html) (hyperlink at "speech of 23 September 2005" and "Staff Discussion Paper," respectively; last visited on 1 Feb. 2006).
63. U.S.-EC Agreement, note 26 *supra*, art I, § 1.
64. For a thorough description of the cooperative process see John J. Parisi, Enforcement Cooperation among Antitrust Authorities, available at <http://www.ftc.gov/speeches/other/ibc99059911update.htm>.
65. See, e.g., Commission Report to the Council and the European Parliament on the Application of the Agreement Between the European Communities and the Government of the United States of America Regarding the Application of Their Competition Laws, COM(98) 509 final at 5.
66. See, e.g., *Mergers and Joint Ventures Roundtable*, 1994 FORDHAM CORP. L. INST.: INTERNATIONAL ANTITRUST LAW & POLICY 165, 187-195 (Juris Publishing 1995); see also Robert Pitofsky, *International Antitrust: An FTC Perspective*, 1995 FORDHAM CORP. L. INST.: INTERNATIONAL ANTITRUST LAW & POLICY 6-9 (Juris Publishing 1996).
67. The ICN issued in June 2005 a comprehensive paper on waivers of confidentiality, including model waiver forms, available at <http://www.internationalcompetitionnetwork.org/NPWaiversFinal.pdf>.
68. *Rules for Regulators: What Is Good for the EU Is Good for US Trade Relations*, FINANCIAL TIMES, 4 Mar. 2003, at 18.
69. See generally Joseph P. Quinlan, DRIFTING APART OR GROWING TOGETHER? THE PRIMACY OF THE TRANSATLANTIC ECONOMY 1-2, 14-15, 22-23, 25-26 (2003), available at <http://transatlantic.sais-jhu.edu/PDF/publications/Quinlan%20Text%20FINAL%20March%202003.pdf>.
70. U.S.-EC Agreement, note 26 *supra*, art I, § 1.

**Pamela Jones Harbour is a Commissioner of the U.S. Federal Trade Commission.**



***International Law Practicum***  
***New York International Law Review***  
***New York International Chapter News***  
**Available on the Web**  
**[www.nysba.org/ilp](http://www.nysba.org/ilp)**

**Back issues of the *International Law Practicum*, *New York International Law Review* and *New York International Chapter News* (2000-present) are available on the New York State Bar Association Web site**

Back issues are available at no charge to Section members. You must be logged in as a member to access back issues. Need password assistance? Visit our Web site at [www.nysba.org/pwhelp](http://www.nysba.org/pwhelp). For questions or log-in help, call (518) 463-3200.

***International Law Practicum*, *New York International Law Review* and *New York International Chapter News* 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.

# Private Enforcement of Competition Law in the EU: Trials and Tribulations

By Johan Ysewyn

## I. Cross-Atlantic Inspiration

The U.S. Sherman Act of 1890<sup>1</sup> was modeled on the English Statute of Monopolies of 1623,<sup>2</sup> under which monopolies were prohibited and treble damages and double costs were awarded to the injured party. Over a century later, the European Union is looking to the United States for inspiration with regard to the enforcement of competition law.

It is widely acknowledged that competition law enforcement has two aims: to deter companies from breaching competition law, on the one hand, and to punish wrongdoers, on the other. These aims are inter-linked: the extent to which potential transgressors are deterred depends upon the level of the sanction and the likelihood of being caught. The prime rationale behind enforcement measures is thus to make it uneconomical for companies to breach competition law.

To increase the likelihood of detecting the most serious antitrust offenders, the Commission, drawing on the success of the United States' corporate and individual cartel leniency policies, introduced a cartel leniency policy in 1996, under which whistle-blowers were rewarded with a reduction in or waiver of the fine. In 2002, that policy was reinforced, again drawing on the U.S. experience, by requiring a greater degree of cooperation from whistle-blowers, on the one hand, and by providing a higher degree of legal certainty for them, on the other. In addition, seventeen of the European Union's twenty-five member states now have their own cartel leniency programs, with varying scope, and two others have draft policies in the pipeline.

In recent months, a second U.S. competition law enforcement measure has stolen the limelight in Brussels. For over forty years, competition enforcement in the European Union has focused on public enforcement by the European Commission. Although fines—both in cartel and in abuse-of-dominance cases—are becoming ever higher and more frequent as the Commission cracks down on the worst offenders, and, in doing so, hopes to deter others, there now appears to be a political imperative to supplement the European Union's enforcement tool kit. Private actions have therefore become the hot topic of the enforcement debate, and legislators and stakeholders are, once again, seeking lessons from the United States, where the emphasis has always been on private rather than public enforcement.<sup>3</sup>

The European Union's modernization of antitrust rules,<sup>4</sup> which came into force on 1 May 2004, paved the way for more private litigation in the Union by allowing national competition authorities and national courts to apply Articles 81 and 82 of the EC Treaty<sup>5</sup> without restriction.<sup>6</sup> In addition, the European Commission has adopted a number of notices that are intended to provide national courts with guidance on the substantive application of the competition rules.<sup>7</sup>

But although national courts in the European Union now have the ability to apply competition rules substantively, EU and national procedural rules are currently insufficiently developed to increase the level of private enforcement. The principles are there, but the detailed application is lacking.

It has, for example, long been a principle of EU law that, in the absence of relevant Community procedural rules, national procedural rules in every member state must ensure that Community rights are protected and can be enforced.<sup>8</sup> Such national rules must neither make Community rights more difficult to enforce than domestic rights nor render their enforcement impossible. In line with this principle, the Court of Justice of the European Communities (ECJ) confirmed the following in *Crehan*:<sup>9</sup>

The full effectiveness of Article 81 of the [EC] Treaty and, in particular, the practical effect of the prohibition laid down in Article 81(1) would be put at risk if it were not open to any individual to claim damages for loss caused to him . . . by conduct liable to restrict or distort competition.<sup>10</sup>

The key reason why private enforcement in the European Union is so rare is because of the divergence between the procedural frameworks in the now twenty-five member states, the majority of which are not at all equipped to deal with antitrust litigation. In contrast with the European Union's fragmentary approach, private enforcement in the United States is much more centralized.<sup>11</sup> Most U.S. procedural measures governing actions for the recovery of competition law damages have a long history and are established at the federal level.

This article contains a review of some of the key features of private enforcement in the United States and, where appropriate, an assessment of whether they would or should be transferable to Europe.

## II. Key Features of Private Enforcement in the U.S.

### A. Treble Damages

Treble damages are central to the private enforcement of U.S. antitrust law and have been a feature of the Sherman Act of 1890 since its inception.

There can be no doubt that mandatory treble damages serve as a deterrent and that they encourage innovative—some would say, spurious—actions for damages. On the other hand, mandatory trebling in the United States has resulted in a restrictive application of the rules on standing and a reluctance to find defendants liable, notably in regard to claims by indirect purchasers.<sup>12</sup> In addition, treble damages are a great incentive for defendants to settle, particularly cartel cases, so that very few actions go to trial. Consequently, there is very little case law on the subject.

Some commentators have suggested—although this is highly controversial—that treble damages are not in fact punitive because they amount only to “single” damages in the context of protracted litigation in the United States, in which plaintiffs have no right to recover pre-judgment interest.<sup>13</sup> In contrast, pre-judgment interest is provided for in some EU jurisdictions, notably in the U.K. and Germany.

There are thus a number of issues to weigh in the balance and a wholesale importation of mandatory trebling into the European Union is probably not appropriate.

### B. Class Actions

A second feature of the U.S. system, also often cited in Europe as a major incentive to potential plaintiffs for antitrust damages, is the provision for class actions. In the United States, an individual can bring an action on behalf of an unidentified group of plaintiffs. In contrast, there is no such provision for class actions in the member states of the European Union.

Some jurisdictions in the European Union, notably the U.K. and Germany, provide for representative actions by, for example, consumer associations, but these have been rarely used or only recently introduced. The European Commission has, however, indicated that it is very keen to enhance class actions in the European Union as a way of encouraging potential claimants to seek redress for competition damages.

### C. Pass-On Defense

The United States Supreme Court held in *Hanover Shoe*<sup>14</sup> that defendants could not escape or reduce their liability by arguing that the plaintiff had “passed on” the unlawfully inflated price paid for the defendant’s goods to their own clients. This policy decision sought to safeguard the deterrent and punitive aims behind U.S. antitrust enforcement rules.

Although a pass-on defense, coupled with rules on standing for indirect purchasers, would ensure that direct purchasers would not be unjustly enriched<sup>15</sup> and that all injured parties would be entitled to compensation, it would also render antitrust litigation more fragmented and less certain. Even if procedural rules allowed for class actions to encourage all direct and indirect purchasers to be joined in the proceedings, it is unlikely that all potential claimants would be joined in the action. Moreover, the knowledge that potential claimants for damages face such hurdles would reduce the deterrent effect of private actions on potential antitrust abusers.

### D. Indirect Purchasers

Plaintiffs in U.S. antitrust damages claims must show that they have suffered damage as a consequence of the lessening of competition caused by the defendant’s antitrust injury. In *Illinois Brick*,<sup>16</sup> the U.S. Supreme Court interpreted the Clayton Act<sup>17</sup> so as to exclude indirect purchasers from claiming antitrust damages in U.S. federal courts. The Court’s findings were influenced by the draconian effect on defendants of treble damages; the increased complexity of tracing causation between sellers and several levels of indirect purchasers; and the risk, in the absence of a pass-on defense, of double liability in damages for the defendant, amounting to six-fold liability under mandatory trebling.<sup>18</sup>

Following the *Illinois Brick* ruling, around 30 states have legislated to exclude the prohibition against indirect purchasers’ claims in so-called *Illinois Brick* repealer statutes, under which indirect purchasers can bring proceedings in state (but not in federal) courts. The U.S. Supreme Court subsequently confirmed that states are not precluded from legislating in this way.<sup>19</sup>

An assessment of the rights of indirect purchasers is thus inextricably linked with an analysis of the merits of a pass-on defense. The European Union is therefore likely to deal with both topics in tandem. There appear to be at least three ways of addressing the issues:

- to allow direct and indirect purchasers to claim damages but not to allow a pass-on defense, thereby punishing the defendant, but also over-compensating at least some of the victims;

- to allow direct and indirect purchasers to claim damages and to allow a pass-on defense, thereby providing fair compensation but making enforcement more complex and reducing its deterrent effect; or
- to allow indirect purchasers to claim damages from direct purchasers, thereby ensuring fair compensation but lessening the incentive on direct purchasers to institute proceedings because they will anticipate having to forego some of their winnings in subsequent actions by indirect purchasers.

#### E. Burden and Standard of Proof; Evidentiary Rules

It goes without saying that the burden for making out a case is on the plaintiff. This principle can represent a real hurdle to plaintiffs in jurisdictions that do not have U.S.-style discovery rules. Very few of the member states' procedural regimes provide for discovery, and it is almost inconceivable that this situation will change. There are, however, alternative ways of easing the burden on plaintiffs. For example, Paragraph 20(5) of the German GWB<sup>20</sup> places the onus on the defendant to disprove abuse of dominance in cases brought by small- and medium-sized enterprises (SMEs) who show a *prima facie* case.

An interesting feature of modern antitrust enforcement is that leniency applications to the European Commission can now be made orally in order to avoid the reach of discovery orders made in the context of related private actions for damages in the United States or in other jurisdictions with discovery rules.<sup>21</sup> The provision for oral submissions raises new problems. First, it is not clear whether enforcement procedures could be taken against antitrust abusers in the European Union on the basis of oral statements alone. Second, there is no provision for penalizing false statements made by the whistle-blower. Third, private litigants in an EU member state with discovery rules are similarly unable to obtain copies of whistle-blowers' statements to the Commission, hampering their ability to claim damages.

The U.S. Clayton Act<sup>22</sup> provides that a final judgment or decree finding that a defendant has violated antitrust laws constitutes *prima-facie* evidence against the defendant in subsequent private actions for damages. In the United States, this has given defendants an incentive to settle their cases with the public authorities, thereby avoiding a judgment or decree, which would ease the evidential burden on potential private claimants.<sup>23</sup>

Under Article 16 of Regulation 1/2003,<sup>24</sup> national courts assessing agreements, decisions or practices that

are already the subject of a Commission decision are precluded from making rulings "running counter to the decision adopted by the Commission." It appears therefore that private litigants in national damages cases should not need to prove liability if the Commission has already issued a decision to this effect and if the claim is against one of the addressees of the Commission decision.

#### F. Interplay with Leniency Claims

There has been some discussion about how emphasizing private enforcement may hamper the effectiveness of cartel-leniency programs, which provide protection only against public enforcement measures. In the United States, this problem has now been addressed in the Antitrust Criminal Penalty Enhancement and Reform Act of 2004,<sup>25</sup> which provides for the detrebbling of damages for whistle-blowers who cooperate with the plaintiffs in private damage actions.

The European Commission has indicated that it will have to address the disincentive effect that private actions have on cartel leniency. In the meantime, the new U.S. rule will also act as an incentive to potential whistle-blowers in the European Union, because a risk assessment will be more likely to favor cooperating across the board, given the reduced penalties in the United States.

#### G. Jurisdiction

The most widely debated private enforcement issue to have emanated from the United States in recent years concerned the protracted action for damages against vitamin cartelist Hoffman-LaRoche. The main question that interested commentators was whether foreign plaintiffs who had purchased vitamins abroad had standing to institute an action for damages in U.S. courts. The U.S. Supreme Court<sup>26</sup> held that the Foreign Trade Antitrust Improvements Act of 1982<sup>27</sup> precluded such actions, except when (i) the alleged harm was direct, substantial and foreseeable and (ii) the effect on U.S. commerce gave rise to a claim under the Sherman Act.<sup>28</sup> The plaintiffs would, according to the ruling of the U.S. Supreme Court, be barred from bringing a claim if the damage they had suffered was "independent" of the cartel's effects on U.S. commerce.

The plaintiffs argued that their injuries arose out of the implementation of the cartel in the United States because U.S. vitamin producers had to keep prices high to prevent U.S. wholesalers from profitably reselling vitamins abroad. The U.S. Court of Appeals for the District of Columbia, to which the Supreme Court had referred the question of "independence," delivered its opinion in June 2005. In tune with the principle of "prescriptive comity,"<sup>29</sup> the court found that U.S. courts



lacked jurisdiction because the plaintiffs' injuries had arisen directly out of the excessive prices abroad and only indirectly from the inflated prices in the United States.<sup>30</sup> In other words, plaintiffs must show proximate causation. The European arm of the vitamin litigation is discussed in Part IV below.

### III. Private Enforcement in the EU

The topic of private enforcement was strangely absent from the Commission's Communication in 2004 entitled "A pro-active Competition Policy for a Competitive Europe."<sup>31</sup> But in one of his last speeches as Competition Commissioner last year, Mario Monti focused on private litigation "as a key complement to public enforcement of competition rules." He also said that he was confident that the new Commission would devote the necessary resources to the issue.<sup>32</sup>

Commissioner Monti identified the main benefits of private enforcement as:

- deterring antitrust infringers and leading to greater compliance with competition rules;
- increasing private actions and increasing awareness of competition rules; and
- filling a gap in cases in which public-enforcement authorities might not take action.

The Commission published a multi-jurisdictional study on the conditions of claims for damages for infringement of EC competition rules in the twenty-five member states of the European Union, in August 2004.<sup>33</sup> The opening sentence of that study states that "[t]he picture that emerges from the present study on damages actions for breach of competition law in the enlarged EU is one of astonishing diversity and total underdevelopment." Some of the key barriers to private enforcement identified were as follows:

- a total absence of multi-jurisdictional litigation;
- a lack of clarity of the legal basis or bases for bringing a claim;
- the absence of class actions in many jurisdictions;
- the fact that consumers lack standing to bring actions for damages in some jurisdictions, for example, in Finland and Sweden;
- the use of nonspecialized courts to hear claims;
- the principle that the loser pays the costs and the absence of contingency fee arrangements;
- the fact that the burden of proof is on the plaintiff, who must meet a high standard of proof;

- the difficulty in assessing damages;
- the near absence of punitive damages; and
- diverse limitation periods across different jurisdictions.

Competition Commissioner Neelie Kroes has undertaken the publication of a Green Paper on private enforcement of competition law, which was published in December 2005.<sup>34</sup> The idea is, first, to add another weapon to the European Union's anti-cartel enforcement artillery and, second, to compensate the victims of hard-core anti-competitive behavior. In September 2005, Commissioner Kroes addressed the subject in no fewer than three speeches, for the first time outlining some of the detail of the impending Green Paper, which she said at the time was likely to cover "topics like access to evidence, the fault requirement, the calculation of damages, collective actions, costs of proceedings and of course, the pass-on defense and the question of standing for indirect purchasers."<sup>35</sup>

The Commission will be asking itself, however, to what extent it is within the European Union's jurisdiction to legislate in this area.

Articles 61(c) and 65(c) of the EC Treaty provide a legal basis for adopting measures, for civil cases with cross-border implications, "eliminating obstacles to the good functioning of civil proceedings, if necessary by promoting the compatibility of the rules on civil procedure applicable in the Member States."<sup>36</sup> Article 153(2) of the EC Treaty provides that consumer protection requirements should be taken into account in defining and implementing other Community policies and activities. There is no corresponding provision protecting the interests of competitors.

An example of legislation in this area is the Commission's proposal for a regulation on the law applicable to noncontractual obligations (referred to as the "Rome II" regulation).<sup>37</sup> Article 5 of the proposal provides that damage claims for unfair competition will be determined in the jurisdiction in which competitive relations exist or the collective interest of consumers are or are likely to be directly and substantially affected. The aim of this provision is to harmonize the conflicts rules of member states, thereby eliminating a reason for forum-shopping, and to protect consumers.

Commissioner Kroes's aim is to ensure that, in addition, certain minimum procedural standards are respected in every member state, such as provisions allowing class actions, on the one hand, and granting rights of standing in competition damage claims to consumers, consumers' associations, and competitors, on the other.

#### IV. The Vitamins Cartel

No discussion about private actions for competition law damages would be complete without a closer look at the question of jurisdiction in the wake of recent actions against the vitamin cartelists.<sup>38</sup>

In the 1990s, vitamin manufacturers including Aventis (then known as Rhône-Poulenc), BASF, and Hoffmann-LaRoche, were pursued in the United States and the European Union because of price-fixing and market-sharing cartels. The fines against Hoffmann-LaRoche were the highest ever imposed by the U.S. Department of Justice (U.S. \$500 million) and the European Commission (£462 million).

Some of Hoffmann-LaRoche's customers brought actions for damages. In *Provimi*,<sup>39</sup> the English High Court found that it had jurisdiction to hear a claim by a German customer of a German Hoffmann-LaRoche subsidiary, who had instituted proceedings in London against the following:

- a U.K. subsidiary of Hoffmann-LaRoche with which the plaintiff had no business relationship; and
- the German subsidiary.

Among the prerequisites for the high court's findings were its adoption of the broad EU concept of "undertaking" and its holding that it was not necessary to show a concurrence of wills between two legal entities within the undertaking.

This was a clear case of forum shopping: the U.K. courts, allowing discovery, class actions, and exemplary (punitive) damages, are likely to be a favorite forum for private claimants.

An appeal to the court of appeal was withdrawn when the case was settled. Nevertheless, pending determination of the issues by a higher court, plaintiffs can rely on the high court's judgment in support of the claim that the U.K. courts should have jurisdiction in similar cases.

As for the German arm of the litigation, German courts had long dismissed vitamin damage actions brought by direct purchasers, on the basis that any damage had in fact been suffered by end customers. The District Court of Dortmund (*Landgericht Dortmund*) changed the direction of German case law in April 2004<sup>40</sup> and required Hoffmann-La Roche to pay damages in excess of 1.5 million, rejecting the defendant's pass-on defense. The court held that although the defendant's conduct had not specifically been aimed at the plaintiffs, it constituted unlawful conduct with the general purpose of increasing prices and harming market participants, including direct purchasers.

A recent legislative reform in Germany, which came into force on 1 July 2005 has resolved some areas of uncertainty relating to antitrust damage actions:

- Revised Paragraph 33(1) of the GWB<sup>41</sup> extends protection (i.e., standing) to all parties (i.e., market participants) affected by the infringement although there remains doubt as to whether there will be a rise in actions by indirect purchasers in the absence of the availability of class actions or discovery.
- New Paragraph 33(3) of the GWB appears not wholly to preclude a pass-on defense.<sup>42</sup>
- As in the U.K., pre-judgment interest is allowed.
- With regard to the plaintiff's evidentiary burden, the GWB provides expressly that final decisions by member states' competition authorities or the European Commission are binding on German courts on the question of liability. In the absence of discovery rules, this new rule will be welcome to potential plaintiffs. Commentators have argued, however, that its wording is too broad because it fails to specify that the binding effect of the decisions is limited to claims against their addressees. Even defendants who are neither able to defend themselves in foreign public enforcement proceedings nor are referred to in the final decision may therefore be at risk.

#### V. Conclusion

The European Union and its member states are influenced by the United States' longer experience in antitrust enforcement. Many member states, however, have their own rich history in civil procedure in general and antitrust procedure in particular. It is unlikely therefore, that U.S. antitrust procedural rules would be imported into the European Union wholesale, and it would be undesirable for that to occur. Although the European Commission has sought inspiration from across the Atlantic in drafting its consultative Green Paper, Competition Commissioner Kroes is aware of the potential pitfalls and has stated the following:

We want to use the debate to identify the appropriate incentives for private damage claims, while avoiding unmeritorious and even vexatious claims. We want to use the debate to find ways to increase deterrence, while avoiding the situation where defendants settle simply because litigation costs are too high.

In short, if we want to use the debate to see how we can do the European economy a favor. How we can foster a com-

petition culture, not a litigation culture.<sup>43</sup>

As we have seen, some national courts are actively contributing to the debate in their innovative and expansive interpretation of national rules on jurisdiction and standing.

## VI. Bibliography

Donald I. Baker, *Revisiting History—What Have We Learned About Private Antitrust Enforcement that We Would Recommend to Others?*, 16 *LOY. CONSUMER L. REV.* 379 (2004).

Foad Hoseinian, *Passing-on Damages and Community Antitrust Policy—An Economic Background*, 28 *WORLD COMPETITION* 3-24 (Kluwer 2005).

Gary R. Spratling & D. Jarrett Arp, *A New Paradigm for Counsel Responding to International Cartel Investigations*, 6 *GLOBAL COMPETITION REV.* 28 (October 2003).

Hans Vedder, *Spontaneous Harmonization of National (Competition) Laws in the wake of Modernization of EC Competition Law*, 1 *COMPETITION L. REV.* 5 (Aug. 2005). See <http://www.clasf.org/CompLRev/assets/Vol1Issue1Article1.pdf>.

James S. Venit, *Brave New World: The Modernization and Decentralization of Enforcement under Articles 81 and 82 of the EC Treaty*, 40 *COMMON MKT. L. REV.* 545 (Kluwer 2003).

Wouter P.J. Wils, *Should Private Antitrust Enforcement Be Encouraged in Europe?*, 26 *WORLD COMPETITION* 473 (Kluwer 2003). See <http://www.joensuu.fi/taloustieteet/ott/scandale/tarto/papers/private%20enforcement.pdf>.

Donncadh Woods, Ailsa Sinclair and David Ashton, *Private Enforcement of Community Competition Law: Modernization and the Road Ahead*, *Commission Competition Pol’y Newsl.* 31 (Summer 2004). See [http://europa.eu.int/comm/competition/publications/cpn/cpn2004\\_2.pdf](http://europa.eu.int/comm/competition/publications/cpn/cpn2004_2.pdf).

Wolfgang Wurmnest, *A New Era for Private Antitrust Litigation in Germany? A Critical Appraisal of the Modernized Law Against Restraints of Competition*, 6 *GERMAN L.J.* 1173 (Aug. 2005). See <http://www.germanlawjournal.com/article.php?id=626>.

4. As laid down in Council Regulation 1/2003, 4 Jan. 2003, 2003 O.J. (L1) 1. The Commission’s proposal for the Regulation (COM (2000) 582) described one of the aims of the Regulation as “promoting private enforcement through national courts.” Recital 7 of Regulation 1/2003 provides that, “National courts have an essential part to play in applying the Community competition rules. When deciding disputes between private individuals, they protect the subjective rights under Community law, for example by awarding damages to the victims of infringements. The role of the national courts here complements that of the competition authorities of the Member States.”
5. Treaty Establishing the European Community, 24 Dec. 2002, 2002 O.J. (C 325) 33 (herein, the “EC Treaty”).
6. Article 81 of the EC Treaty prohibits anticompetitive agreements or collusion and Article 82 of the EC Treaty prohibits the abuse of dominance. Previously, only the Commission could exempt restrictive agreements under Article 81(3) of the EC Treaty.
7. See, e.g., Commission Notice on the co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82 EC, 27 Apr. 2004, 2004 O.J. (C 101) 54; Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty, 27 Apr. 2004, 2004 O.J. (C 101) 81; and Guidelines on the application of Article 81(3) of the Treaty, 27 Apr. 2004, 2004 O.J. (C 101) 97.
8. Case 33/76, *Rewe v. Landwirtschaftskammer Saarland*, 1976 E.C.R. 1989.
9. Case C-453/99, *Courage Ltd. v. Crehan*, 2001 E.C.R. I-6297.
10. *Id.* at Point 26 of the judgment. The ECJ went on to say the following:

Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community.

*Id.* at point 27 of the judgment. The Commission Notice on the co-operation between the Commission and the courts of the EU Member States in the application of Articles 81 and 82, note 7 *supra*, summarizes the current ECJ case law at paragraphs 9-14.

11. An exception is the treatment of the question whether indirect purchasers should have standing in actions for the recovery of antitrust damages, which is discussed in Part II.D *infra*.
12. See discussion in Part II.D *infra*.
13. Patricia Hanh Rosochowicz, *Deterrence and the Relationship Between Public and Private Enforcement of Competition Law*, Amsterdam Centre for Law & Economics Working Paper Series, University of Amsterdam.
14. *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 88 S. Ct. 2224, 20 L. Ed. 2d 1231 (1968).
15. Unjust enrichment would occur if direct purchasers both (i) recouped the excessive prices they had paid by charging their customers similarly inflated prices and (ii) were awarded damages on the basis that they had suffered injury as a result of the unlawfully inflated prices.
16. *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 97 S. Ct. 2061, 52 L. Ed. 2d 707 (1977).
17. Clayton Act, 38 Stat. 731 (1914), now codified at 15 U.S.C. §§ 12-27.
18. In *Hanover Shoe*, note 14 *supra*, the Supreme Court prohibited the use of a pass-on defense by the defendant seller to reduce liability.

## Endnotes

1. 15 U.S.C. §§ 1-7.
2. 21 Jac. 1, c.3.
3. Over 90% of antitrust actions in the United States are private.

- ity. The Supreme Court in *Illinois Brick*, note 16 *supra*, could have decided to overrule or limit the prohibition to justify allowing indirect purchasers to claim against antitrust violators. Instead, the Court opted to limit standing in antitrust damages actions to direct purchasers.
19. *California v. ARC America Corp.*, 490 U.S. 93, 109 S. Ct. 1661, 104 L. Ed. 2d 86 (1989).
  20. *Gesetz gegen Wettbewerbsbeschränkungen* (GWB), BGBl. I/2005, at 2114 et seq. (Germany's Act Against Restraints of Competition).
  21. The knowledge that written leniency applications could be disclosed to plaintiffs claiming damages in other jurisdictions under discovery rules is a disincentive to potential whistleblowers. In the course of the U.S. arm of the vitamins litigation, the plaintiffs' lawyers did in fact obtain written documents submitted to the European Commission.
  22. 15 U.S.C. §§ 12-27.
  23. In U.S. criminal cases, the settlement order (plea agreement) includes a judgment that constitutes prima facie evidence.
  24. Council Regulation 1/2003, 4 Jan. 2003, 2003 O.J. (L1) 1.
  25. Pub. L. No. 108-237, § 215, 118 Stat. 665, 668 (2004), codified in note accompanying 15 U.S.C. § 1.
  26. *F. Hoffmann-LaRoche Ltd. v. Empagran S.A.*, 542 U.S. 155, 124 S. Ct. 2359, 159 L. Ed. 2d 226 (2004).
  27. 15 U.S.C. § 6a.
  28. U.S.C. §§ 1-7.
  29. *Empagran S.A. v. F. Hoffmann-LaRoche Ltd.*, 417 F.3d 1267, 1271 (D.C. Cir. 2005) (referring to such comity as "the respect sovereign nations afford each other by limiting the reach of their laws").
  30. *Id.*
  31. COM (2004) 293 final (20 Apr. 2004).
  32. SPEECH 04/403, Fiesole, 17 Sept. 2004.
  33. See the executive summary entitled "Study on the conditions of claims for damages in case of infringement of EC competition rules," prepared by D. Waelbroeck, D. Slater & G. Even-Shoshan, and accessible through the Web site icon labeled "Comparative report" found at [http://europa.eu.int/comm/competition/antitrust/others/private\\_enforcement/index\\_en.html](http://europa.eu.int/comm/competition/antitrust/others/private_enforcement/index_en.html).
  34. The Green Paper can be found at [http://europa.eu.int/comm/competition/antitrust/others/actions\\_for\\_damages/gp.html](http://europa.eu.int/comm/competition/antitrust/others/actions_for_damages/gp.html). See also SPEECH 05/73, Brussels, 3 Feb. 2005; SPEECH 05/78, Milan, 7 Feb. 2005; and SPEECH 05/157, Brussels, 10 Mar. 2005.
  35. <http://europa.eu.int/rapid/searchAction.do>, New York, 22 Sept. 2005.
  36. Article 65(c) of the EC Treaty.
  37. COM (2003) 427 final (22 July 2003), based on Article 61(c) of the EC Treaty.
  38. The U.S. arm of the litigation is discussed in Part II.G *supra*.
  39. *Provimi Ltd. v. Roche Products Ltd.*, [2003] EWHC 961 (Q.B.), [2003] 2 All E.R. (Comm.) 683.
  40. Judgment by the District Court (*Landgericht*) of Dortmund (13 O 55/02), published in 15 *Europäisches Wirtschafts- und Steuerrecht* No. 9, Sept. 2004, at 434-346.
  41. See note 20 *supra*.
  42. New Section 33(3) of the GWB provides that "[i]f a good or a service was purchased at an inflated price, damages are not precluded because the good or the service was resold."
  43. <http://europa.eu.int/rapid/searchAction.do>, New York, 22 Sept. 2005.

**Johan Ysewyn is a partner in the Brussels and London offices of Linklaters.**



# Jurisdictional Issues in International Cartel Cases: A Canadian Perspective

By Donald B. Houston and Jeanne L. Pratt

## I. Introduction

In most industries, competition is increasingly global in scope, no longer localized to one region, state or country. Although borders have become increasingly irrelevant in business, they raise important jurisdictional issues in the enforcement of competition laws, both in criminal and civil proceedings. International cartel activity presents challenging issues for alleged cartel participants, enforcement authorities and plaintiffs suing to recover damages.

With respect to private actions in particular, jurisdictional issues raised by a claim for damages allegedly suffered as a result of international cartel activity can permeate every stage of an action, from service of the claim to enforcement of any judgment or award of costs. For defendants, jurisdictional challenges may be an important option to consider in a defense strategy. For plaintiffs, overcoming the difficulties of having a claim certified, proceeding through trial and enforcing a judgment against a defendant with no ties to Canada can present a challenging prospect.

## II. Jurisdiction of Canadian Courts over “Foreign” Conspiracies

### A. Civil Actions Brought Pursuant to Section 36 of the *Competition Act*

In Canada, private actions brought by persons who have been harmed by the anti-competitive conduct of others are available as a means of private enforcement of competition laws. Section 36 of the *Competition Act*<sup>1</sup> grants a right of private action with respect to conduct that is contrary to the criminal provisions of the statute, allowing a plaintiff to sue to recover damages. Claims brought pursuant to Section 36 must be instituted within two years after the date of the completion of criminal proceedings or the last date on which the conduct was engaged in, whichever is later.

For conspiracy claims, the most relevant criminal provisions of the *Competition Act* are Sections 45 and 46. Under Section 45 everyone “who conspires, combines, agrees or arranges with another person” to prevent or lessen competition “unduly” is guilty of an indictable offense and subject to criminal penalties. Under Section 46 a corporation carrying on business in Canada that implements a foreign conspiracy in Canada, regardless of whether it has knowledge of the foreign conspiracy, is guilty of an indictable offense and subject to criminal penalties. Section 36 allows persons who have suffered

harm as a result of such conspiracies to bring civil damage claims in the courts. Where one or more defendants in a Section 36 action has pleaded guilty to an offense under the statute, the “record of proceedings” may be used in the subsequent civil action against that defendant as proof that it engaged in conduct contrary to the statute’s criminal provisions.<sup>2</sup> In addition, any admissions made in the criminal proceedings are admissible as evidence in the subsequent civil proceedings.<sup>3</sup>

Unlike in private antitrust claims in the United States, there is no provision for treble damages in Canada. In a Section 36 action, the plaintiff must suffer quantifiable harm and must prove its actual loss at trial. The plaintiff may only recover the amount of its actual losses plus the costs of pursuing the legal action, including the costs of investigating the matter and the costs of court proceedings.<sup>4</sup> In addition to the statutory claim, a plaintiff may (and generally does) allege common law tortious activity, such as civil conspiracy or intentional interference with economic relations. A plaintiff may also claim punitive damages, provided that common law tortious activity is proven in addition to a Section 36 claim. However, the threshold for an award of punitive damages is high: they may only be awarded where there is evidence of egregious, high-handed conduct on the part of the defendants.<sup>5</sup>

Many Section 36 claims are brought as class proceedings and are usually issued after one or more of the defendants have pleaded guilty to, or have been proven guilty of, criminal anti-competitive conduct. In Canada, there is no national class proceedings legislation. Instead, many of Canada’s provinces have their own regimes. Despite the lack of a national regime, courts in some provinces have certified national classes of plaintiffs.<sup>6</sup> In practice, competition law claims have usually been launched in one or more provinces, each of which may seek to certify a national class. Once a national class is certified in one province, proceedings in other provinces, while not technically precluded from continuing, may be stayed pending the outcome of the action in the first certifying province. It is important to note, however, that it is not yet clearly established in Canada that certification of a national class in one province precludes the continuation of class proceedings in a second province. In effect, this could mean that a defendant could settle or defend a class proceeding involving a certified national class and yet still face continuing or new proceedings in other provinces.

## B. Criminal Jurisdiction under Sections 45 and 46

The focus of this article is on civil claims. However, civil claims under Section 36 of the *Competition Act* must be based on conduct contrary to the statute's criminal provisions. As such, it is useful to consider some of the jurisdictional issues which may arise in criminal proceedings under the statute's conspiracy provisions.

### 1. Subject Matter Jurisdiction

Section 45 of the *Competition Act*, the main conspiracy provision, does not contain an express territorial limitation or extension. Section 46 purports to extend indirectly criminal jurisdiction over foreign cartels by rendering Canadian affiliates liable for implementing a conspiracy, whether or not the Canadian affiliate had knowledge of the foreign cartel.<sup>7</sup> Apart from Section 46, the territorial reach of Canada's criminal anti-cartel laws is determined in accordance with Canada's common law regarding the assumption of criminal jurisdiction.

Canada's common law includes a presumption against the application of its criminal law beyond Canada's borders. The Supreme Court of Canada has held "that a state has exclusive sovereignty over all persons, citizens or aliens, and all property, real or personal, within its own territory."<sup>8</sup> The general rule, which has been codified in the *Criminal Code*, is that Canadian courts are only competent to enforce Canadian criminal laws within Canada.<sup>9</sup> However, this is not an absolute rule. A state may enact specific legislation providing for extraterritoriality in special circumstances, such as war crimes and crimes against humanity. A state may also enforce its laws abroad where another state explicitly so consents for a limited purpose.<sup>10</sup>

The *Competition Act* does not expressly provide for extraterritorial application of its provisions, including its conspiracy provisions. Section 465 of the *Criminal Code* gives Canadian courts jurisdiction over foreign conspiracies to commit offenses in Canada, but it does not assist the Crown in a case under Section 45 of the *Competition Act*, where the offense is the conspiracy itself. As a result, the conspiracy has to be considered to have been committed in Canada in order for a Canadian criminal court to assume jurisdiction. The question therefore becomes: when is a conspiracy to lessen competition considered to have been committed in Canada?

In *R. v. Libman*,<sup>11</sup> the Supreme Court of Canada articulated a broad test to determine whether a Canadian court ought to assume criminal jurisdiction where alleged criminal conduct originated in Canada but affected only individuals in the United States. The accused ran a telephone marketing scheme from Canada which used misrepresentations to induce American residents to buy shares in mining companies located in Central America. Although the money for the mining shares was sent to Central America, the accused received a share of the pro-

ceeds and returned to Canada. The accused were charged with fraud and conspiracy to commit fraud. They argued that the *Criminal Code* provisions with respect to conspiracy to commit fraud applied only to conspiracies entered into in Canada to commit substantive offenses in Canada. Since the essence of the offense of conspiracy to commit fraud had occurred in the United States, where the victims had suffered the losses, the Canadian court could not exercise jurisdiction. In rejecting this argument, LaForest J. articulated the following test to determine when Canadian courts ought to assume jurisdiction over a criminal offense:

As I see it, all that is necessary to make an offence subject to the jurisdiction of our courts is that a significant portion of the activities constituting the offence took place in Canada. As it is put by modern academics, it is sufficient that there be a "real and substantial link" between an offence and this country . . .<sup>12</sup>

The court went on to say that in determining whether a real and substantial link to Canada exists, the courts "must . . . take into account all relevant facts that take place in Canada that may legitimately give this country an interest in prosecuting the offence" before considering whether there is anything in those facts that offends principles of international comity.<sup>13</sup> In *Libman*, the Supreme Court of Canada held that there were sufficient facts connecting the offense to Canada to allow Canadian courts to assume jurisdiction.

The test set out in *Libman* appears to permit a generous discretion to apply Canada's criminal laws to foreign entities, provided that there is a factual link between the alleged crime and Canada and provided that it would not offend other countries to apply Canada's criminal laws to their citizens. Remarkably, the test in *Libman* has never been considered in the context of a competition conspiracy prosecution under the *Competition Act*. Whether potential anti-competitive effects in Canada are sufficient to found jurisdiction over a conspiracy entered into outside Canada remains an open question.

Most Canadian criminal proceedings against foreign entities for international cartel activity in Canada end with a guilty plea and a statement of admissions which explicitly states that the foreign entity is only submitting to Canada's jurisdiction in the interests of settling the investigation against it. For many accused, the certainty of a negotiated plea and statement of admissions, as compared to the uncertainty inherent in a contested proceeding, permits some measure of control and foreseeability regarding the potential business ramifications of a guilty plea. This may explain why the "real and substantial" connection test has never been tested in a Canadian court in a Section 45 prosecution against a foreign

national for alleged cartel activity which occurred wholly outside of Canada but had anti-competitive effects in a Canadian market.

It is arguable that the assumption of criminal jurisdiction over a foreign defendant for an alleged conspiracy entered into outside Canada by an entity with no business presence in Canada is not supported by the provisions of the *Competition Act*. Section 45 provides that it is an offense to enter into an agreement to unduly lessen competition. The offense is complete when the agreement is made; no further acts are required. Section 46 then provides that it is a criminal offense for an entity carrying on business in Canada to implement a directive from a person “in a country other than Canada . . . for the purpose of giving effect to a conspiracy entered into outside Canada that, if entered into in Canada” would have been contrary to Section 45 [emphasis added]. The clear implication from these provisions is that conspiracies entered into outside Canada by entities who do not carry on business in Canada are not contrary to Section 45. Note, however, that this argument was rejected in *obiter dicta* in *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*,<sup>14</sup> a civil case, discussed below.

The fact that the scope of these provisions is a live issue is substantiated by the form of indictment sometimes chosen by the Attorney General of Canada with respect to foreign companies with no affiliates in Canada. In such cases, the Attorney General, in the context of negotiated pleas of guilty, has been inventive, charging foreign companies with *aiding and abetting* an offense under Section 46 rather than seeking to indict those companies directly under Section 45. In other words, it is alleged that the foreign company aided and abetted a foreign competitor in directing the competitor’s Canadian affiliate to implement a conspiracy entered into outside Canada.<sup>15</sup> The jurisdictional validity of such an indictment has never been tested in a Canadian court, and we question whether the twice-removed jurisdictional nexus to Section 46 in such a case is “real and substantial.”

## 2. Personal Jurisdiction

In criminal cases, in addition to subject matter jurisdiction the Crown also has to establish personal jurisdiction over the accused. Unless there is a specific statutory exception, an accused can only be served with an originating summons if he or she or it is physically present in Canada and is served personally.<sup>16</sup> For a corporate accused, Section 703.2 of the *Criminal Code* provides that service must be effected by physical delivery to the manager, secretary or other executive of the corporation or a branch thereof. Extradition may be available for individuals, but only if the accused is located in a country which has an extradition treaty with Canada. Corporations cannot be extradited.

There is no express provision in the *Criminal Code* or the *Competition Act* which permits service *ex juris* in criminal prosecutions, and attempts by the authorities to read provincial offense service procedures that permit service *ex juris* into the *Criminal Code* have so far failed. In *R. v. R.J. Reynolds Tobacco (Delaware)*<sup>17</sup> the corporate accused, charged with corporate fraud, did not have a business presence in Canada. The Crown attempted to serve an originating summons by sending it by registered mail to the accused’s address in the United States. Section 701.1 of the *Criminal Code* provides that the service procedures of a province may be adopted for the purposes of *Criminal Code* offenses. The Crown argued that it had effected valid service on the corporate accused because it had served the summons in accordance with Ontario’s *Provincial Offences Act*.<sup>18</sup> In finding that such service was not effective, Gans J. drew a distinction between the procedure permitted for service under the *Criminal Code* and the effectiveness of such service. The incorporation by reference of a province’s service procedures did not constitute a statutory exception to the rule that service of a summons under the *Criminal Code* was only effective if served personally on an accused. The decision in *R.J. Reynolds* is under appeal.

The rule against *ex juris* service of criminal summons makes it difficult for Canadian prosecutors to exercise jurisdiction over foreign companies in the absence of voluntary attornment. As discussed below, this is not the case for civil plaintiffs seeking damages resulting from cartel conduct.

## C. Jurisdiction over Civil Cartel Claims

In contrast to the approach in criminal prosecutions, Canadian courts have taken a less restrictive approach to their jurisdiction over civil claims brought pursuant to Section 36 of the *Competition Act* or the common law tort of conspiracy. The rules of civil procedure in all provinces provide for service *ex juris*, making the first step of serving a claim an easier hurdle to overcome than in criminal proceedings. However, for foreign defendants who have been served with a statement of claim for an alleged conspiracy under Section 36 of the *Competition Act* or for the common law tort of conspiracy, challenging the jurisdiction of the Canadian court may be the first response.

The Ontario Rules of Civil Procedure permit service *ex juris* without leave of the court if a tort is committed in Ontario, damage is sustained in Ontario, a person outside Ontario is a necessary or proper party to the action, or a defendant is carrying on business in Ontario.<sup>19</sup> The Rules and other legislation also provide that a foreign defendant served *ex juris* with a Canadian statement of claim and who has not otherwise attorned to the Canadian jurisdiction may move to have that service set aside.<sup>20</sup> On such a motion, where the defendant adduces evi-



dence that puts facts essential to jurisdiction in issue, the plaintiff may be required to demonstrate that there is a good arguable case established on the face of the pleading that the court has jurisdiction based on one of the factors which permit service *ex juris* without leave.<sup>21</sup>

In addition to moving to set aside service *ex juris*, a foreign defendant may seek to have the action stayed on the grounds that the Canadian jurisdiction is not a convenient forum (under the doctrine of *forum non conveniens*) or that it lacks jurisdiction *simpliciter*.<sup>22</sup> In regard to jurisdiction *simpliciter*, the Supreme Court of Canada has held that a Canadian court may assume jurisdiction over foreign parties in civil proceedings where there is a “real and substantial connection” between the Canadian jurisdiction and the subject matter of the litigation, and where the assumption of jurisdiction would not offend the principles of international comity.<sup>23</sup> Absent a “real and substantial connection,” a Canadian court should not take jurisdiction, even if the rules for service *ex juris* have been complied with. Motions to set aside service *ex juris* or for a stay on the basis of *forum non conveniens* or to challenge jurisdiction *simpliciter* are often brought together.

A key case in Ontario on a foreign defendant’s ability to have service set aside or the action stayed is *Wilson v. Servier Canada Inc.*, a pharmaceutical product liability class action.<sup>24</sup> The French parent company of a Canadian affiliate (which had also been sued) had been served *ex juris*. The French parent company brought a motion to set aside service of the claim on the grounds that service was not effective under the terms of the Hague Convention<sup>25</sup> and to stay the Ontario action on the grounds that Ontario was not the most convenient forum for the action.

The court held that the essence of the claim against the French parent company was that it had committed a tort against class members both directly and through the Canadian affiliate acting as its agent.<sup>26</sup> As such, the claim asserted that both defendants had committed torts in Ontario. Further, because the drug involved was marketed in Canada, the representative plaintiff was from Ontario and the plaintiff had purchased and ingested the drug in Ontario, there was a real and substantial connection between the subject matter of the action and Ontario. This was so despite the fact that the only connection that the parent company had to Canada was as the sole shareholder of the Canadian subsidiary, and despite the existence of an article of the French *Code Civil* which had been interpreted by French courts to provide French corporations with the right to have claims adjudicated against them by a French court. In regard to the validity of service *ex juris*, the court held that by delivering a notice of intent to defend and waiting approximately eight months to bring its motion to set aside service the French parent had attorned to the jurisdiction of the Ontario court.

A civil claim alleging a foreign conspiracy contrary to Section 45 of the *Competition Act* may raise significant jurisdictional issues. The only civil conspiracy case to date in which proceedings against foreign defendants in Canada have been challenged is *Vitapharm Canada Ltd. v. F. Hoffman-La Roche Ltd.*<sup>27</sup> In *Vitapharm* the plaintiffs in five proposed Ontario class proceedings served claims *ex juris* alleging price-fixing and market allocation conspiracies against the multinational producers of several vitamin products. The plaintiffs relied on Section 36 of the *Competition Act* but also alleged common law conspiracies and other torts. Some of the foreign defendants brought motions to set aside *ex juris* service of the claim. They also argued that Ontario was not a convenient forum and that it lacked jurisdiction *simpliciter*.

In *Vitapharm*, there were some Canadian defendants in each action, some of the foreign defendants had affiliates in Canada and some foreign defendants had pleaded guilty in prior criminal prosecutions under Section 45 of the *Competition Act*. As such, Cumming J. held that none of the foreign defendants had adduced sufficient evidence to put jurisdiction at issue and that the pleading established a good arguable case that the prerequisites for service *ex juris* were met. In doing so, Cumming J. referred to American case law that held that there is a presumption that a price-fixing scheme will cause damage to the purchasers of the price-fixed product.<sup>28</sup> In addition, Cumming J. dismissed the notion that a foreign corporation cannot be responsible for the alleged unlawful conduct of its affiliates or subsidiaries, stating:

If the conspiracies are proven, it is arguable that a price-fixing scheme concocted outside Canada, but then implemented inside Canada through subsidiaries or affiliates, constitutes carrying on business in Canada on the part of the co-conspirators. It is arguable that the corporate veil of a domestic subsidiary or affiliate may be pierced in such a situation and that the principal (parent or affiliated corporation) involved in the conspiracy is itself carrying on business in Ontario. In such instance, it is arguable that the subsidiaries or affiliates are in reality mere agents of the principals for the purposes of the conspiracy. . . .

Foreign corporations may be regarded as “carrying on business” for the purposes of special or assumed jurisdiction when the business they conduct through an agent in Ontario involves the commission of intentional wrongs by the foreign corporation.<sup>29</sup>



Cumming J. in *obiter* also rejected the argument that such a conspiracy entered into outside Canada could not be actionable in Canada, stating:

In my view, there is a good arguable case that any conspiracy entered into abroad that fixes prices or allocates markets in Canada so as to create losses through artificially higher prices in Canada, gives rise to the tort of civil conspiracy in Canada. It is arguable that a conspiracy that injures Canadians gives rise to liability in Canada, even if the conspiracy was formed abroad.

The moving defendants argue that ss. 45 and 46 of the Competition Act render a conspiracy to fix prices a criminal offence only when the agreement is made within Canada. Again, I disagree. The language of s. 45 is not directed to only those conspiracies entered into within Canada.

The moving defendants submit that s. 46 is to be properly interpreted as imposing limiting language in respect of offences under s. 45. I disagree. Section 46 creates an offence for persons beyond those who are not co-conspirators but knowingly implement in whole or in part in Canada any directive for the purpose of giving effect to a conspiracy.<sup>30</sup>

Cumming J. also dismissed the defendants' motion for a stay based on the application of the doctrine of *forum non conveniens*. The fact that all of the defendants' witnesses and evidence were located in a different jurisdiction did not displace the loss of juridical advantage that the plaintiff would suffer if the actions proceeded in other jurisdictions.

In *Vitapharm*, as noted above, there were numerous factual connections with Canada, including guilty pleas in Canada by several foreign defendants. In our view, *Vitapharm* should not close the door to jurisdictional challenges in future cases where these connections do not exist. In an alleged market allocation conspiracy, for example, there may be alleged participants who do not have any business presence in Canada, did not have any sales into Canada and who have not pleaded guilty to an offense in Canada. In the alternative, there may be an allegation that foreign defendants conspired outside Canada to fix prices in North America but without specific reference to Canada. In such cases, it is arguable that the required "real and substantial connection" with Canada does not exist.

It is also arguable that such allegations, even if true, would not constitute an offense in Canada contrary to Sections 45 or 46 of the *Competition Act*, and therefore could not be the basis for a claim under Section 36. There is no express language in Section 45 to extend its reach to alleged conspiracies committed outside Canada. As mentioned above, Section 46 limits liability to corporations "carrying on business in Canada" which implement a directive from a participant in a conspiracy entered into outside Canada that "if entered into in Canada" would have violated Section 45. Alleged conspiracies entered into outside Canada by persons who do not carry on business in Canada are arguably outside the scope of Section 45.<sup>31</sup>

Finally, before challenging the jurisdiction of a Canadian court in a civil international cartel case, defendants must carefully consider all of the consequences of success. If the effect of successfully challenging jurisdiction in Canada is that the defendant is then sued for treble damages in the United States, it will not have been a good choice for the defendant.

### III. Canadian Plaintiffs Seeking to Recover for International Cartel Activity in the United States—the Effects of *Empagran* in Canada

In *F. Hoffmann-LaRoche Ltd. v. Empagran S.A.*,<sup>32</sup> the United States Supreme Court considered the jurisdiction of American courts to entertain treble damage claims by foreign purchasers of products that are allegedly the subject of price-fixing. In the United States, plaintiffs who suffer loss or damage as a result of conduct that is contrary to the Sherman Act<sup>33</sup> are entitled to collect treble damages—a prospect that is very attractive to plaintiffs in Canada and in other parts of the world.

In *Empagran*, foreign purchasers of vitamins brought claims in the United States alleging that they had suffered damages as a result of an international conspiracy to fix the price of vitamins. The lower courts were divided on whether an American court could assume jurisdiction and apply American antitrust law when the alleged conduct has direct, substantial and reasonably foreseeable effects in the United States but the foreign plaintiff's injury is independent of the American effects.

In the United States, the Foreign Trade Antitrust Improvement Act<sup>34</sup> (FTAIA) generally precludes the application of the Sherman Act to "conduct involving trade or commerce (other than import trade and commerce) with foreign nations." However, there is an important exception to this rule where two prerequisites are met: the conduct has "a direct, substantial, and reasonably foreseeable effect" on American domestic commerce, and the direct, substantial and reasonably foreseeable effect gives rise to a claim under the Sherman Act.

In *Empagran* the District Court judge interpreted the exception in the FTAIA as requiring a direct effect within the United States stemming from the foreign conduct.<sup>35</sup> Because the foreign plaintiffs in *Empagran* had not alleged precise injuries stemming from the direct American domestic effects, their claims lacked the required connection under the FTAIA and were dismissed. The United States Court of Appeals for the District of Columbia reversed, holding that the FTAIA exception permits foreign plaintiffs who suffer loss as a result of the foreign effects of the international cartel conduct to sue in the United States as long as the conduct gives rise to a private claim by an American plaintiff under the Sherman Act.<sup>36</sup>

The United States Supreme Court reversed, holding that foreign purchasers cannot use American courts to pursue damages for price-fixing conspiracies where their damages are “independent” of those suffered by purchasers in the United States. In so holding, *Empagran* puts to rest the contention that the exception in the FTAIA could apply to provide foreign purchasers with treble damage claims in American courts against foreign companies where they could demonstrate simply that there was an effect of the international conspiracy on American commerce.

The United States Supreme Court held that the exception in the FTAIA ought to be interpreted so as to avoid unreasonable interference with the sovereign authority of other nations. As a result, in order to bring themselves within the jurisdiction of American courts, foreign plaintiffs must demonstrate that the effect on foreign plaintiffs of the anticompetitive conduct is not independent of the adverse domestic effect on American commerce. The United States Supreme Court did not specify when an effect is considered to be independent of the effect on American domestic commerce and remanded the question of whether such an effect existed on the facts pleaded in *Empagran* back to the Court of Appeals. On remand, the Court of Appeals held that the foreign plaintiffs’ claim was properly pleaded and ordered the parties to submit full merits briefs and further oral argument on whether the alleged link between foreign injury and domestic effect was legally sufficient to come within the FTAIA exception.<sup>37</sup> Having heard that argument, it concluded that the *Empagran* plaintiffs’ claims were outside the jurisdiction of the U.S. Courts.<sup>38</sup>

The foreign plaintiffs in *Empagran* argued that because the subject vitamins are commodities that are traded on a global market, the defendants’ alleged fixing of prices in the United States and limiting of trade between the United States and other countries permitted the defendants to extract profits from plaintiffs abroad. As a result, the foreign plaintiffs argued that their injuries arose from the American effects of the defen-

dants’ conduct and thereby satisfy the requirements of the FTAIA exception.<sup>39</sup>

Canada, along with several other countries,<sup>40</sup> filed a brief as *amicus curiae* in support of the defendants. The Canadian brief submitted that if the foreign plaintiffs were successful, it would render Canada’s immunity program ineffective and would permit Canadians to bypass Canada’s sovereign decision to permit only single damage recovery in civil actions, “even for sales within Canada between Canadian nationals.”<sup>41</sup> Further, it submitted that the link which the foreign plaintiffs allege in *Empagran* is a link that could be found to exist for all conspiracies which operate across national boundaries, and which has been recognized by the American courts in the past as insufficient to found the extraterritorial application of United States law. In other words, they argued that, if the Court of Appeals were to find the necessary link in *Empagran*, it would open the door for the application of American law to every conspiracy with an international aspect.

In June, 2005, the Court of Appeals dismissed the plaintiffs’ claims. It decided that, based on the facts presented in *Empagran*, the plaintiffs had not met the burden of demonstrating that the effect on U.S. domestic commerce was adequately tied to the effects on foreign commerce to permit the foreign plaintiffs to pursue their claims in the U.S.<sup>42</sup> The Court of Appeals held that, although maintaining super-competitive prices in the U.S. may have facilitated charging comparable prices abroad, this was not an adequate dependent effect to oust the sovereign laws of foreign jurisdictions and permit the plaintiffs to recover under U.S. laws. The Court held that to come within the FTAIA exception, a foreign plaintiff must show that the U.S. domestic effects were the “proximate cause” of the plaintiffs’ foreign injury.

Since the release of the United States Supreme Court’s decision in *Empagran* (but before the Court of Appeals decision) many foreign purchaser cases have been remanded to lower courts for consideration of possible links between domestic effects and foreign harm.<sup>43</sup> In other cases, it has been held that the requisite domestic effect had not been sufficiently pleaded to bring the plaintiffs within the FTAIA exception.<sup>44</sup>

In another recent case, it was held that an adequate connection to the United States had been pleaded so as to permit a claim of a foreign plaintiff to proceed under the exception in the FTAIA. In *MM Global Servs. v. Dow Chem. Co.*,<sup>45</sup> the plaintiff acted as the nonexclusive distributor for Union Carbide products in India, purchasing Union Carbide products in the United States and reselling them in India. When Union Carbide merged with Dow Chemical, the distributorship was terminated. MM sued both Dow Chemical and Union Carbide, alleg-

ing that they had compelled MM to engage in a price maintenance conspiracy with respect to the resale of the products in India. The District Court dismissed the defendants' motion challenging the claim, holding that the defendants' alleged fixing of minimum resale prices had an effect on competition in both the sale and resale of the products in the United States and that as a result of that effect, MM could sue in the United States.

It is questionable whether the decision of the Court of Appeals in *Empagran* will put significant constraints on Canadian purchasers who wish to bring their claims in the United States. In most international cartel cases which involve Canada, the allegation is a North American conspiracy, not separate conspiracies relating to Canada and the United States. In those cases, Canadian purchasers will continue to have an argument that their claims are not independent of the effect of the conspiracy on American prices. Hence, Canadian plaintiffs who want to advance their claims in the United States, and thus sue for treble damages, may not be turned away by American courts. However, and perhaps fortunately for Canadian defendants, there is an active class plaintiffs' bar in Canada which continues to bring these claims in Canada rather than pursuing them in the United States.

#### IV. Canadian Recognition of Foreign Judgments

Two recent Canadian cases have expanded the test for recognition and enforcement of foreign judgments by Canadian courts. While neither of these decisions is a competition law case, they have important ramifications for civil proceedings arising from alleged international cartel activity. These cases suggest that plaintiffs who may have been eligible to participate in settlements or judgments in foreign class proceedings may be barred from bringing subsequent proceedings in Canadian courts. They also make it easier for plaintiffs to enforce their foreign judgments in Canada.

In *Beals v. Saldanha*<sup>46</sup> the Supreme Court of Canada held that a Florida judgment was enforceable in Ontario. The claim involved a real estate transaction in Florida. The defendants had filed a defense to the original Florida claim, but did not defend subsequent amendments to the claim. Pursuant to Florida rules, the plaintiffs obtained a default judgment against the defendants, which they then sought to enforce in Ontario.

In holding that the Florida judgment was enforceable in Ontario, the Supreme Court of Canada held that Canadian courts should recognize and enforce a judgment of a foreign court where the foreign court had a "real and substantial connection" with either the subject matter of the action or the defendant. It thereby applied the test that the Supreme Court of Canada had articulated in *Morguard Investments Ltd. v. De Savoye*<sup>47</sup> for judgments from other provinces to judgments from other countries.

In *Parsons v. McDonald's Restaurants of Canada Ltd.*,<sup>48</sup> Cullity J. of the Ontario Superior Court applied the *Beals* test in the context of a class proceeding. In *Parsons* the defendants applied to stay two Ontario class proceedings on the grounds of *res judicata* and abuse of process. The basis for the application was a prior Illinois judgment approving a settlement of a similar class action in Illinois.

*Parsons* involved promotional contests run by McDonald's in the United States and Canada. An employee of the marketing company hired by McDonald's to run the promotions pleaded guilty in the United States to stealing prizes. A class action was then commenced in Illinois on behalf of all customers of McDonald's in the United States and Canada who had bought McDonald's food products in the hopes of winning a prize. The Illinois class action was settled, and that settlement was approved by the Illinois court, whose order specifically provided for notice of the settlement to be provided to Canadian customers through advertisements in *MacLean's* magazine and two French language newspapers in Quebec.

One of the subsequent Canadian plaintiffs, Parsons, appeared in Illinois to challenge the jurisdiction of the Illinois court over Canadian customers and to object to the sufficiency of notice to Canadian customers. Those arguments were rejected by the Illinois court. The Illinois judgment gave class members a set period within which to opt out of the settlement, failing which their claims would be barred.

After the Illinois judgment had been issued, two proposed class actions were commenced in Ontario, advancing essentially the same claims as those made in Illinois, but only on behalf of Canadian customers. One of the actions was commenced by Parsons, who had appeared in Illinois to contest jurisdiction, and the other was commenced by Currie, who had not appeared in Illinois.

McDonald's then applied to stay the proposed Ontario class proceedings on the grounds of abuse of process and *res judicata*. Cullity J. applied the *Beals* test, holding that the Illinois court had a "real and substantial connection" with the subject matter of the action. He found that Parsons had attorned to the jurisdiction of the Illinois court, so that his claim was barred, but that Parsons' attornment did not bind other members of the proposed class, including Currie. With respect to these other class members, Cullity J. held that they were not bound by the Illinois judgment because the notice they received of the Illinois settlement was not sufficient. It seems clear, however, that if the notice had been sufficient, the Illinois judgment would have barred subsequent Canadian claims.

After *Parsons*, the defendants in the Ontario class proceeding sought to limit the Canadian class to those



plaintiffs who opted out of the Illinois settlement after adequate notice of the Illinois settlement had been provided. Cullity J. dismissed the motion, holding that the relief sought by the defendants would have required a potential Ontario class member who wished to participate in the Ontario proceeding to take the positive step of opting out of the Illinois settlement.<sup>49</sup> This would be tantamount to requiring the plaintiffs to opt in to the Ontario proceedings.

The Ontario Court of Appeal affirmed the decision of Cullity J. Sharpe J.A. stated:

In my view, provided (a) there is a real and substantial connection linking the cause of action to the foreign jurisdiction, (b) the rights of non-resident class members are adequately represented, and (c) non-resident class members are accorded procedural fairness including adequate notice, it may be appropriate to attach jurisdictional consequences to an unnamed plaintiff's failure to opt out. In those circumstances, failure to opt out may be regarded as a form of passive attornment sufficient to support the jurisdiction of the foreign court . . .

I consider the motion judge's ruling on the adequacy of notice below and conclude that there is no basis upon which I would interfere with that ruling. I would apply it to the question of jurisdiction and hold that as the unnamed plaintiffs were not afforded adequate notice of the Boland proceedings, the Ontario courts should not recognize and enforce the Boland judgment against Currie and the non-attorning Canadian class members he seeks to represent.<sup>50</sup>

*Parsons* and *Beals* are important for civil proceedings in competition law matters, especially class proceedings, which involve alleged international cartels. Prior proceedings or settlements in the United States or elsewhere can significantly impact, or even bar, subsequent Canadian proceedings. These cases also suggest that Canadian defendants who may be successfully sued elsewhere for their part in cartel activity, such as in the United States for treble damages, will be subject to having those foreign judgments enforced against them in Canada.

Canadian defendants in these cases may face the "double whammy" of (i) American courts taking an expansive view of their jurisdiction over the treble damage claims of foreign (including Canadian) plaintiffs and (ii) a greater willingness of Canadian courts to enforce foreign (including American) judgments in Canada. Canadian defendants seeking to resist enforcement of

American judgments in Canada would have to show that the American court did not have a real and substantial connection with the subject matter of the action.

## V. Anti-Suit Injunctions

The effects of *Empagran* on Canadian plaintiffs seeking to collect treble damages in American courts for international cartel activity have yet to be definitively determined by American courts. As noted above, we do not expect them to constrain significantly claims by Canadian purchasers in cases involving alleged North American conspiracies. As a result, given the difference between exposure to treble damages under American law and single damages in Canada, defendants may choose to seek anti-suit injunctions in Canada to restrain Canadian plaintiffs from pursuing their claims in the United States.

Earlier in this article we discussed the factors that a Canadian court considers when faced with a request to stay its own proceedings on the basis that it is not the most appropriate forum for the action. In an anti-suit injunction, instead of a defendant in Canadian litigation seeking a stay from a Canadian court with respect to the Canadian litigation, a defendant in foreign litigation seeks an order from a Canadian court enjoining a Canadian plaintiff from launching or continuing an action in a jurisdiction outside Canada. In either case, the Canadian court considers the doctrine of *forum non conveniens* and examines the connections between the potential jurisdictions and the subject matter and parties to the litigation.

The leading Canadian case on anti-suit injunctions is *Amchem Products Inc. v. British Columbia (Workers' Compensation Board)*.<sup>51</sup> In that case, individuals who had worked in the manufacturing of asbestos products by various companies in several provinces in Canada and the state of Washington sued in Texas, alleging that several of the manufacturers had failed to provide adequate warnings regarding the dangers of exposure to asbestos. Most of the claimants resided in British Columbia, and the British Columbia Workers' Compensation Board was a subrogated claimant with respect to most of the individuals. Most of the thirty-three corporate defendants in the Texas action did not have a significant business presence in Canada. After the action was commenced in Texas, most of the thirty-three defendants brought a motion in the Texas court challenging its jurisdiction and seeking a stay on the grounds that Texas was *forum non conveniens*. The Texas court dismissed the motion without reasons. After many attempts to reverse this decision, several of the defendants brought applications in British Columbia seeking anti-suit injunctions against the claimants in the Texas action. The British Columbia Supreme Court issued an *ex parte* injunction, following which the non-British Columbia claimants in the Texas action sought an "anti-anti-suit" injunction from the



Texas court to prevent the defendants from obtaining similar injunctions against them in Canada.

The decision of the British Columbia court was eventually appealed to the Supreme Court of Canada, which held that the anti-suit injunction should not have been granted. Sopinka J. drew the following distinction between seeking a stay of proceedings and seeking an anti-suit injunction:

Although both the remedy of a stay and an injunction have as their main objectives the selection of an appropriate forum for the trial of the action, there is a fundamental difference between them which is crucial to the development of the principles which should govern each. In the case of the stay the domestic court determines for itself whether in the circumstances it should take jurisdiction whereas, in the case of the injunction, it in effect determines the matter for the foreign court.<sup>52</sup>

The threshold to convince a Canadian court to prevent a plaintiff from continuing with an action in a foreign jurisdiction is higher than it is for a motion to stay a proceeding in a Canadian court. Sopinka J. stated “In some cases a serious injustice will be occasioned as a result of the failure of a foreign court to decline jurisdiction. It is only in such circumstances that a court should entertain an application for an anti-suit injunction.”<sup>53</sup> However, the Supreme Court of Canada was also clear that “forum shopping” ought not to be encouraged:

The choice of the appropriate forum is still to be made on the basis of factors designed to ensure, if possible, that the action is tried in the jurisdiction that has the closest connection with the action and the parties and not to secure a juridical advantage to one of the litigants at the expense of another in a jurisdiction that is otherwise inappropriate.<sup>54</sup>

In considering whether to grant an anti-suit injunction, a domestic court should first determine whether the domestic forum is the natural forum with the closest connection to the action and the parties or, in contrast, whether there is another forum that is clearly more appropriate. If the foreign court, applying the principles of the doctrine of *forum non conveniens*, could reasonably have concluded that there was no other forum that is clearly more appropriate, the domestic court should not displace the foreign court’s assumption of jurisdiction. Further, even where the domestic court finds that there was a clearly more appropriate forum, it ought not to interfere with the plaintiff’s choice of forum if the plain-

tiff would be unjustly deprived of an advantage in the foreign jurisdiction that is not available in the domestic jurisdiction.

Where Canadian plaintiffs seek the advantage of treble damages by bringing litigation in the United States under the exception to the FTAIA and the United States Supreme Court’s decision in *Empagran*, an anti-suit injunction may be the defendant’s next step if and when those Canadian plaintiffs are permitted by an American court to proceed. Presumably, the American court would have found a nexus between the effect on Canadian commerce and American domestic commerce. A critical issue, therefore, is whether the American court’s decision would foreclose the Canadian courts from restraining the Canadian plaintiffs’ ability to continue with the American action under the *Amchem* test.

The *Amchem* test provides that, where an American court in applying the factors for *forum non conveniens* could have reasonably concluded that no other forum is clearly more appropriate, the Canadian court should not interfere. The *Empagran* test provides that foreign plaintiffs must demonstrate some nexus between the adverse effect they have suffered and an adverse effect on American domestic commerce. The United States Supreme Court also held in *Empagran* that the exception in the FTAIA ought to be interpreted so as to avoid unreasonable interference with the sovereign authority of other nations. The burden on a defendant seeking an anti-suit injunction from a Canadian court will be to demonstrate that the American court, in allowing American litigation to proceed, erred in its consideration of the unreasonableness of the interference with the sovereign authority of Canada and that the American court did not, in its analysis, give adequate thought as to whether Canada was clearly a more appropriate forum. This will be a difficult burden to satisfy.

However, a finding that there is a nexus to a direct effect on American commerce under the test in *Empagran* is not the same as concluding that there is a “real and substantial connection” to the United States. In effect, the *Empagran* test only considers half of the *forum non conveniens* test. It only considers whether there is a connection to the United States, and does not consider whether there are closer connections to another jurisdiction.

Treble damages are the single most important reason why a Canadian plaintiff would seek to sue in the United States for anticompetitive loss or harm suffered in Canada. Another reason is that under American antitrust laws, unlike in Canada, plaintiffs alleging price-fixing or market allocation need not prove that the defendants’ conduct led to an “undue” lessening of competition, since such conduct is *per se* illegal under the *Sherman Act*. These factors become relevant under the third portion of the *Amchem* test, which provides that even where a Canadian court finds that Canada is clearly the more

appropriate forum, it ought not to interfere with the plaintiff's choice of forum if the plaintiff would be *unjustly* deprived of an advantage in the United States that is not available in Canada.

In *Amchem*, the Supreme Court of Canada held that a juridical advantage to the plaintiff is just one of the factors to be considered in the analysis of connecting factors, stating:

If a party seeks out a jurisdiction simply to gain a juridical advantage rather than by reason of a real and substantial connection of the case to the jurisdiction, that is ordinarily condemned as "forum shopping." On the other hand, a party whose case has a real and substantial connection with a forum has a legitimate claim to the advantages that that forum provides. The legitimacy of this claim is based on a reasonable expectation that in the event of litigation arising out of the transaction in question, those advantages will be available.<sup>55</sup>

Based on this test, the defendants would have to demonstrate not only that Canada is clearly the more appropriate jurisdiction based on connecting factors, but also that the reason the Canadian plaintiffs chose the United States was for the advantages provided by the *per se* rule and the prospect of treble damages. Further, the defendants would have to demonstrate that it would not be unjust to deprive the plaintiffs of these advantages.

Canada's *Competition Act*, through Section 36, and the common law tort of conspiracy provide Canadian plaintiffs with causes of action for losses actually suffered as a result of an anticompetitive conspiracy. Consequently, plaintiffs in Canada do have a mechanism in Canada by which to recover their actual losses. They would not be deprived of their cause of action if an anti-suit injunction were granted in these circumstances. They would only be deprived of the ability to treble their damages and to establish liability without proving the competitive effects required by Canadian law. From a public policy standpoint, those who do business in Canada legitimately expect that their conduct will be judged by Canadian law. Canadian plaintiffs precluded from bringing their claims in the United States under American law would not be unjustly deprived of an advantage. They would only be deprived of an advantage that Canadian lawmakers do not consider appropriate for Canada. Therefore, there should be at least some cases in which Canadian courts would restrain Canadian plaintiffs from pursuing treble damage claims in the United States.

Consider, for example, an industry based largely in Canada but with some sales into the United States. If

Canadian plaintiffs alleged a conspiracy to fix North American prices and sought to bring their claims in the United States, it would appear, under *Empagran*, that an American court might take jurisdiction. A Canadian defendant in that situation should have a credible argument, in a Canadian court, that it should not face treble damages or *per se* liability merely because of the Canadian plaintiffs' decision to sue in the United States. However, we are not aware of any case in which this argument has been advanced to date.

## VI. Access by Canadian Plaintiffs and Courts to Evidence in Foreign Proceedings

If and when a Canadian court assumes jurisdiction over a civil proceeding alleging illegal international cartel activity, other jurisdictional issues may arise at the discovery and production stages of the proceeding. Plaintiffs in several countries may bring actions against the same alleged cartel participants in several jurisdictions. For example, a consumer may sue a European-based corporate defendant in the United States, alleging the same conduct as a different consumer suing the same defendant in Canada. The same defendant may have also been subject to investigations by competition authorities in Europe, the United States and Canada.

Plaintiffs or prospective plaintiffs will be keenly interested in monitoring the progress of proceedings in other jurisdictions and in getting access to any information produced in those proceedings to further their own case. Canadian plaintiffs may bring motions in other jurisdictions for access to material that they may not have access to in Canada. Two recent cases, decided on opposite sides of the Canada/United States border, will likely encourage further attempts by Canadian plaintiffs to gain access to information that is not available to them under the relevant Canadian procedural rules.

In *Ford v. F. Hoffmann-LaRoche Ltd.*<sup>56</sup> the plaintiffs in a series of proposed class proceedings were bringing motions in an American court seeking access to the discovery in parallel American actions—information that was subject to a protective order in the American litigation. If successful on their motions, the plaintiffs would have been permitted to obtain discovery evidence to investigate and support their class proceedings pending in Ontario, before the class proceeding had been certified in Ontario and before their discovery rights in Ontario were operative. In response, the Canadian defendants brought motions in Ontario to prohibit the plaintiffs from proceeding with their motions in the United States. Pending the outcome of those motions in Ontario, the American court deferred its decision on whether to give the plaintiffs access. The Canadian courts declined to intervene. The Ontario courts, and ultimately the Supreme Court of Canada, rejected the defendants' attempts to prohibit the American motions from proceeding. In doing so, they held, *inter alia*, that because

the Ontario court retains jurisdiction regarding the admissibility of any information obtained from the American proceeding, it was unnecessary for the Ontario court to interfere with the American courts' jurisdiction over the motions before it.

In their motion in the United States, the plaintiffs relied on Federal Rule of Civil Procedure 24(b), which provides that "upon timely intervention anyone may be permitted to intervene in an action . . . when an applicant's claim or defense and the main action have a question of law or fact in common." American courts have held that the requirements for permissive intervention under 24(b) are: (i) an independent basis of subject matter jurisdiction; (ii) a timely motion to intervene; and (iii) a claim or defense that has a question of law or fact in common with the main action.<sup>57</sup> All three of these requirements have been interpreted broadly to apply to parties who raise a common question in a proceeding in another jurisdiction and who seek to modify a confidentiality order in American litigation, even after the American proceedings have been completed.<sup>58</sup> In the motion brought by the plaintiffs in *Ford*,<sup>59</sup> the United States District Court found these criteria to be met, but deferred modification of the protection order until the Ontario court had made its decision.

In addition to *Ford*, Canadian plaintiffs were granted intervenor status under Rule 24(b) and protective orders were modified permitting them access to confidential discovery in *In re Baycol Products Litigation*<sup>60</sup> and, most recently, *In re Linerboard Antitrust Litigation*,<sup>61</sup> discussed below.

In addition to Rule 24(b), Canadian or other foreign plaintiffs can seek access to discovery materials in the United States pursuant to 28 U.S.C. Section 1782(a), the utility of which has recently been affirmed by the United States Supreme Court. In *Intel Corp. v. Advanced Micro Devices, Inc.*,<sup>62</sup> the United States Supreme Court set out rules for foreign parties seeking access to American production for use in foreign proceedings, expanding the rights of foreign complainants and plaintiffs to seek access to information produced in litigation in the United States, regardless of whether the same information would be discoverable in the foreign proceedings.

In *Intel*, Advanced Micro Devices filed an antitrust complaint against Intel Corp. with the Directorate-General for Competition of the Commission of the European Communities, alleging that Intel had abused its dominant position in the European market through loyalty rebates, exclusive purchasing agreements, price discrimination and standard-setting cartels. Although Advanced Micro Devices had recommended to the Directorate-General that it seek documents produced or filed by Intel in a private antitrust action filed in Alabama, the Directorate-General decided not to seek such production.

Advanced Micro Devices then applied to the District Court for an order directing Intel to produce the documents, relying on Section 1782(a), a statutory provision enacted in 1964 to encourage American judicial assistance for foreign proceedings. Section 1782(a) provides that a federal district court "may order" a person residing or found in a district to give testimony or produce documents "for use in a proceeding in a foreign or international tribunal" upon the application of "any interested person."

The Court of Appeals for the Ninth Circuit permitted production of the materials sought.<sup>63</sup> Intel then appealed to the United States Supreme Court, supported by an *amicus* brief from the Commission. The Commission stated that it did not want or need the assistance of the District Court. Further, it characterized its own function as being more in the nature of a prosecuting authority than a tribunal within the meaning of Section 1782(a), and expressed concern that granting the relief sought could lead to the disclosure of confidential information, encourage fishing expeditions, and undermine the Commission's Leniency Program.

Despite these concerns, the United States Supreme Court affirmed the decision of the Ninth Circuit, holding that:

- a complainant before the European Commission qualifies as an "interested person" within the meaning of Section 1782(a);
- the Commission is a "tribunal" within the meaning of Section 1782(a) when it acts as a decision maker at first instance;
- the "proceeding" for which discovery is sought under Section 1782(a) must be in reasonable contemplation, but need not be "pending" or "imminent;" and
- Section 1782(a) contains no threshold requirement that evidence sought from a federal district court would be discoverable under the law governing the foreign proceeding.

The United States Supreme Court rejected the argument that Section 1782(a) was intended to restrict assistance to litigants in foreign proceedings to seeking information that would be discoverable in the litigant's home jurisdiction. In *Intel*, this would have meant that the Directorate-General could only seek the assistance of the American courts to obtain information that would also be compellable in the Commission's investigation. In rejecting a foreign-discoverability threshold, the court noted that the domestic tribunal would retain the jurisdiction to determine the use to be made of any information produced from the American proceeding in accordance with its own domestic laws.



The United States Supreme Court stopped short of granting the order for production. It cautioned that Section 1782(a) authorizes, but does not require, the federal district court to provide judicial assistance to foreign or international tribunals or to “interested persons” abroad. The merits of Advanced Micro Devices’ application was remanded to the District Court for determination, and the District Court ultimately declined to order production on the facts.<sup>64</sup>

Since *Intel*, American district courts have exercised their discretion under Section 1782(a) in favor of granting access to discovery in American proceedings by foreign litigants. In the case of *In re Proctor & Gamble Co.*<sup>65</sup> the District Court for the Eastern District of Wisconsin allowed Proctor & Gamble access to discovery evidence in American proceedings for use in foreign patent infringement proceedings pending in several countries in Europe and in Japan. Proctor & Gamble was the defendant in all of the actions and sought access to discovery in the American action from the parties who were the plaintiffs in all of the foreign actions. The plaintiffs resisted the motion for production on the basis that both they and Proctor & Gamble were participants in the foreign proceedings and, as such, Proctor & Gamble could obtain discovery in those proceedings—it should not receive assistance under Section 1782(a) until it exhausted its discovery opportunities in the pending foreign proceedings. The District Court rejected this argument, stating that such a proposal “is inefficient and possibly ineffective,” adding:

It is more efficient for a court located in the Eastern District of Wisconsin to order discovery from persons located in such district than to force P&G to seek the same discovery in as many as five foreign actions and return to this court if its efforts fail.<sup>66</sup>

Access to production was also granted under Section 1782(a) in *In re Application of Jonathan Guy Phillips*<sup>67</sup> and *In re Servicio Pan Americano de Proteccion*.<sup>68</sup>

Aside from the remanded decision in *Intel*, the only case to date to deny access to American production under Section 1782(a) is *Schmitz v. Bernstein, Liebhard & Lifshitz, LLP*.<sup>69</sup> There the Second Circuit applied the *Intel* factors to a securities fraud action against a German corporation in Germany for allegedly misleading investors by overstating the value of its real estate assets. The plaintiffs sought access to documents produced in a private action against the same defendants, based on the same facts, that had been commenced in the United States. In particular, the documents sought had been produced in the American action by a German prosecutor and consisted of documents from the German criminal investigation of the same defendants based on the same

facts alleged in both the United States and Germany. However, the German prosecutor had produced those documents on the condition that they were to be used exclusively in the American action. The court denied access to production under Section 1782(a) based on evidence from the German government that it would jeopardize the ongoing criminal investigation and German sovereign rights and because the evidence sought was from a participant in the German action.<sup>70</sup>

In conspiracy cases, American courts have not drawn a significant distinction between a Canadian plaintiff’s standing under Rule 24(b) and under Section 1782(a). In *Linerboard*,<sup>71</sup> a Canadian company sought to intervene under Rule 24(b) in pending American antitrust litigation, alleging a conspiracy among linerboard manufacturers, for the limited purpose of obtaining access to discovery material in the case that was subject to a confidentiality order. As mentioned above, in *Linerboard*, the American court held that the Canadian plaintiff met all three requirements of Rule 24(b) and therefore granted intervener status and permitted it to access production material subject to an American protective order.

The Canadian company in *Linerboard* did not seek access based on Section 1782(a). The defendants argued that it ought to have sought production by relying on the more direct route of Section 1782(a) rather than Rule 24(b) and argued that it had not met the requirements of Section 1782(a) set out by the United States Supreme Court in *Intel*. In particular, the defendants argued that the Canadian company was seeking to circumvent Canada’s discovery rules in two ways. First, under the Ontario Rules of Civil Procedure the plaintiffs were not yet entitled to discovery, since certification had not yet been granted. Second, under the Ontario Rules of Civil Procedure the plaintiffs would not be entitled to the breadth of discovery that was available in the American proceedings. In dismissing this argument, the District Court referred to the Ontario court’s decision in *Ford* and affirmed the distinction drawn by the Ontario court between seeking discovery in an American action and seeking access to the discovery of the litigants in the American litigation. In the absence of the confidentiality order, the plaintiffs in the American action could have disclosed the fruits of its discovery to the Canadian plaintiffs. It was therefore simply more efficient to grant the Canadian plaintiffs access to the American productions.

So far, American courts have been receptive to requests from Canadian plaintiffs seeking access to discovery in the United States. While this approach may be practical and efficient for plaintiffs, it may overlook several substantive issues. As discussed earlier, most Canadian conspiracy class proceedings are commenced in the wake of guilty pleas by some or all of the defendants.



Those guilty pleas, in turn, are largely the result of Canada's immunity program, which encourages early disclosure of conduct that is contrary to the criminal provisions of the *Competition Act* and which, in the absence of the immunity program, would be difficult to detect and prosecute. Enforcement authorities, as reflected in the *amicus* brief filed by the European Commission in *Intel*, worry that the broadening of rights under Section 1782(a) could undermine the effectiveness of immunity programs. Potential immunity applicants may be less likely to come forward to disclose anticompetitive conduct if the protection from disclosure afforded under the rules of the investigating jurisdiction could be undermined by the production rules of another jurisdiction.

In addition, different approaches to privilege in different jurisdictions could lead to the disclosure of privileged information or information protected from disclosure by statute. For example, the documents produced by a litigant in American proceedings could include a complaint by a party to the Competition Bureau or documents produced to the Competition Bureau during an investigation. Under Canada's law of public interest privilege, complaints or confidential information provided to the Bureau during an investigation would be protected from disclosure. Section 29 of the *Competition Act* also provides some protection of confidentiality. In addition, plea negotiations with the government are protected by settlement privilege in Canada. Those same protections may not apply to the very same documents under American law.<sup>72</sup>

Consequently, if a Canadian plaintiff is granted access to such material by an American court, the protection afforded by Canadian law becomes meaningless. A Canadian plaintiff will end up with access to privileged material. Further, it is uncertain whether a Canadian court would view the production of a document under American rules of court as a waiver of privilege for the purposes of Canadian litigation.

The decisions in *Ford* and *Intel* encourage Canadian plaintiffs to seek discovery in other jurisdictions to support their cases in Canada. In effect, this permits plaintiffs to circumvent the rules of civil procedure that permit rights of discovery and production only after a claim has been certified. Given this potential, the following comments of Matlow J. of the Ontario Divisional Court in *Ford* are somewhat surprising:

It would be beyond belief that a foreign court would purport to assume jurisdiction over an action pending in Ontario and even contemplate granting interlocutory relief for discovery. It is trite to assert that only this Court has jurisdiction to control its own process.<sup>73</sup>

As has been shown such a result is far from beyond belief.

There is a potential glimmer of hope for those seeking to preserve control by Canadian courts over their own process. It flows from the judgment of Farley J. in the Divisional Court decision in *Ford*. He drew a distinction between "passive discovery," which he saw as acceptable, and "active discovery," which he viewed to be more problematic. This will not assist defendants in opposing plaintiffs' applications for access to American discovery, but it may give defendants an argument to oppose future requests to actually conduct discovery in the United States for the purposes of the Canadian proceedings.

## Endnotes

1. R.S.C. 1985, ch. C-34.
2. *Id.* at Section 36(2).
3. *Id.*
4. *Id.* at Section 36(1).
5. *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130.
6. See, e.g., *Wilson v. Servier Canada Inc.* (2000), 50 O.R. (3d) 219 (S.C.J.), leave to appeal to Divisional Court refused, (2000), 52 O.R. (3d) 20 (Div. Ct.); *Carom v. Bre X Minerals Ltd.* (1999), 44 O.R. (3d) 173 (S.C.J.).
7. The validity of Section 46 has not been considered in a contested proceeding.
8. *R. v. Finta*, [1994] 1 S.C.R. 701 at 806 (Cory J.).
9. R.S.C. 1985, ch. C-46, Section 6(2).
10. *R. v. Terry*, [1996] 2 S.C.R. 207 at paras. 14-16.
11. [1985] 2 S.C.R. 178.
12. *Id.* at 212-213.
13. *Id.* at 211.
14. (2002), 20 C.P.C. (5th) 351 (Ont. S.C.J.).
15. See for example the indictment against *Tokai Carbon Co., Ltd.*, online: Strategis: Canada's Business and Consumer Site. <http://strategis.ic.gc.ca/pics/ct/ct502114indictmte.pdf>.
16. *R. v. Shulman* (1975), 58 D.L.R. (3d) 586 (B.C.C.A.) at 591. Subsection 509(2) of the *Criminal Code* provides that a summons must be served personally on an accused.
17. (2004), 182 C.C.C. (3d) 126 (Ont. S.C.J.).
18. R.S.O. 1990, ch. P.33.
19. *Ontario Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, Rule 17.02. Rule 17.02 also permits service *ex juris* without leave of the court where the claim is in respect of property in Ontario, the administration of an estate with a connection to Ontario, contracts governed by Ontario law, or taxes, or where service *ex juris* is provided for by statute.
20. See *id.*, Rule 17.06.
21. *Garipey v. Shell Oil Co.* (2000), 51 O.R. (3d) 181 (S.C.J.) at paras. 41-45; *Nutreco Canada Inc. v. F. Hoffmann-La Roche Ltd.* (2001), 10 C.P.C. (5th) 351 (B.C.S.C.) at para. 21; *Ecolab Ltd v. Greenspace Services Ltd.* (1998), 38 O.R. (3d) 145 (Gen. Div.) at 148; *Furlan v. Shell Oil Co.*, [1999] 11 W.W.R. 261 (B.C.S.C.) at paras. 42-43, *aff'd* (2000), 77 B.C.L.R. (3d) 35 (C.A.); *Ontario New Home Warranty Pro-*

- gram v. General Electric Co.* (1988), 36 O.R. (3d) 787 (Gen. Div.) at 799.
22. See, e.g. *Courts of Justice Act*, R.S.O. 1990, ch. C.43, Section 106.
  23. *Morguard Investments Limited v. DeSavoie*, [1990] 3 S.C.R. 1077 at 1108-1110. See also *Muscutt v. Courcelles* (2002) 60 O.R. (3d) 20 (Ont. C.A.).
  24. *Wilson v. Servier Canada Inc.*, note 6 *supra*.
  25. The Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters signed at The Hague on 15 November 1965.
  26. *Wilson v. Servier Canada Inc.*, note 6 *supra*, at 226.
  27. (2002), 20 C.P.C. (5th) 351 (Ont. S.C.J.).
  28. *In re Alcoholic Beverages Litigation*, 95 F.R.D. 321, 327 (E.D.N.Y. 1982).
  29. *Vitapharm Canada Ltd. v. F. Hoffman-LaRoche Ltd.*, note 27 *supra*, at paras. 81 and 83.
  30. *Id.* at paras. 58-60.
  31. For further elaboration, see Part II(B)(1) above.
  32. [2001] WL 761360 (D.D.C.) (JVL), *rev'd*, 315 F.3d 338 (D.C. Cir. 2003), *vacated* 542 U.S. 155 (2004), *on remand* 388 F.3d 337 (D.C. Cir. 2004).
  33. 15 U.S.C. § 1.
  34. 15 U.S.C. § 6a.
  35. *F. Hoffman-LaRoche Ltd. v. Empagran S. A.* [2001] WL 761360 (D.D.C. 2001).
  36. *F. Hoffman-LaRoche Ltd. v. Empagran S. A.*, 315 F.3d 338 (D.C. Cir. 2003).
  37. *F. Hoffman-LaRoche Ltd. v. Empagran S. A.*, 388 F.3d 337 (D.C. Cir. 2004).
  38. *Empagran S.A. v. F. Hoffmann-LaRoche*, 2005 U.S. App. LEXIS 12743 (D.C. Cir. 2005).
  39. *Empagran S.A. v. F. Hoffman-LaRoche, Ltd.*, File No. 01-7115 (D.C. Cir.), Brief of the Appellants (filed 10 January 2005) at 15-16.
  40. An *amicus curiae* brief has also been filed on behalf of Germany, the United Kingdom, Japan, Switzerland and the Netherlands.
  41. *Empagran S.A. v. F. Hoffman-LaRoche, Ltd.*, File No. 01-7115 (D.C. Cir.), Brief of the Government of Canada as *amicus curiae* (filed 16 February 2005).
  42. *Empagran S.A. v. F. Hoffmann-LaRoche*, 2005 U.S. App. LEXIS 12743 (D.C. Cir. 2005).
  43. See, e.g., *BHP N.Z. Ltd v. UCAR Int'l, Inc.*, 106 Fed. Appx. 138 (3d Cir. 2004).
  44. See, e.g., *Sniado v. Bank Aus. Ag.*, 378 F.3d 210 (2d Cir. 2004).
  45. 329 F. Supp. 2d 337 (D.Conn. 2004).
  46. [2003] 3 S.C.R. 416.
  47. [1990] 3 S.C.R. 1077.
  48. (2004), 45 C.P.C. (5th) 304 (Ont. S.C.J.), *additional reasons at* (2004), 70 O.R. (3d) 53 (S.C.J.), *aff'd* (2005), 250 D.L.R. (4th) 224 (Ont. C.A.) [*Parsons*].
  49. *Currie v. McDonald's Restaurants of Canada Ltd.* (2004), 70 O.R. (3d) 53 (S.C.J.) at para. 16, *aff'd* (2005), 250 D.L.R. (4th) 224 (Ont. C.A.).
  50. *Id.* (Ont. C.A.) at paras. 30-31.
  51. [1993] 1 S.C.R. 897.
  52. *Id.* at 913.
  53. *Id.* at 914.
  54. *Id.* at 912.
  55. *Id.* at 920.
  56. (2003), 223 D.L.R. (4th) 445 (Ont. C.A.), *aff'g* (2002), 212 D.L.R. (4th) 563 (Ont. Div. Ct.), *aff'g* (2001), 6 C.P.C. (5th) 245 (S.C.J.), *leave to appeal to S.C.C. refused*, [2003] S.C.C.A. No. 245 (QL).
  57. *EEOC v. National Children's Center*, 146 F.3d 1042 (D.C. Cir. 1998).
  58. *In re Linerboard Antitrust Litigation*, 333 F. Supp. 2d 333, 339 (E.D. Pa. 2004).
  59. *In re Vitamins Antitrust Litigation*, 2001 U.S. Dist. LEXIS 25068 (D.D.C.).
  60. MDL No. 1431 (D.Minn. 2003) (Pre-trial Order No. 77).
  61. *In re Linerboard Antitrust Litigation*, note 58 *supra*.
  62. 542 U.S. 241 (2004), *on remand*, 2004 U.S. Dist. LEXIS 21437 (N.D. Cal.).
  63. *Advanced Micro Devices, Inc. v. Intel Corp.*, 292 F.3d 664 (9th Cir. 2002).
  64. See note 62 *supra*.
  65. 334 F. Supp. 2d 1112 (E.D. Wis. 2004).
  66. *Id.* at 1115.
  67. 2004 U.S. Dist. LEXIS 16426 (S.D.N.Y.). This was an estates case where the administrators of a British estate sought discovery against American citizens who were not parties to the United Kingdom proceedings.
  68. 354 F. Supp. 2d 269 (S.D.N.Y. 2004). In this case, a Venezuelan security firm was granted access to documents held by HSBC Bank USA that were relevant to litigation brought by HSBC against the security firm in Venezuela for damages suffered when an employee of the security firm absconded with \$5.6 million.
  69. 376 F.3d 79 (2d Cir. 2004).
  70. *Id.* at 84.
  71. *In re Linerboard Antitrust Litigation*, note 58 *supra*.
  72. See e.g., *In re Vitamins Antitrust Litigation*, 2002 U.S. Dist. LEXIS 25815 (D.D.C.), where the District Court for the District of Columbia ordered production of, among other things, letters between Bioproducts' legal counsel and the Competition Bureau with respect to Bioproducts' request for immunity and supporting information.
  73. *Ford v. F. Hoffmann-LaRoche Ltd.*, (2002) 212 D.L.R. (4th) 563 (Ont. Div. Ct.), at para 8.

**Mr. Houston and Ms. Pratt are attorneys with Fraser Milner Casgrain LLP, in Toronto. This paper was originally presented at Litigating Conspiracy: A Symposium on Competition Class Actions, at the Faculty of Law of the University of Western Ontario in April of 2005.**

# UK-US Extradition for Antitrust Offenses

By Robert M. Osgood and Nathy J. Dunleavy

## I. Overview

On 29 September 2005, following a decision by Bow Street Magistrates' Court in London, the UK Home Secretary ordered the extradition to the United States of Ian Norris, the former CEO of the British engineering company, The Morgan Crucible Company plc. Mr. Norris is wanted by Department of Justice ("DOJ") prosecutors on charges of price-fixing and obstruction of justice in a cartel investigation. The case is currently under appeal but, should he be unsuccessful in avoiding extradition, Mr. Norris would become the first individual ever extradited to the US for an antitrust offense.

This article will discuss UK extradition law in general, examining the position both before and after the introduction of the Extradition Act 2003<sup>1</sup> (the "2003 Act"), and considering the recent UK-US treaty on extradition. The *Norris* case and its implications for extradition in the antitrust field will then be discussed.

## II. UK Extradition Law

### A. Extradition from the UK before 2004

Prior to the entry into force on 1 January 2004 of the 2003 Act, requests for extradition from the UK to the US were governed by the provisions of the 1989 Extradition Act (the "1989 Act"), read together with the UK-US extradition treaty of 1972 (the "1972 Treaty").

The 1989 Act adopted a list system. For cases in which the UK had an extradition treaty with the requesting jurisdiction, extradition was only available if the offense in question was designated as an extraditable offense for the purposes of Schedule 1 of the 1989 Act. In the case of extradition to the US, which took place pursuant to the 1972 Treaty, extraditable offenses were listed in the United States of America (Extradition) Order 1976 (S.I. No 2144).

The 1972 Treaty also allowed extradition to the US for "any other offense" provided it was (i) a crime punishable by imprisonment of more than a year in both countries ("dual criminality"), (ii) a felony in the US, and (iii) an "extraditable offense" under UK law. The reason for this approach was to enable extradition for new offenses as they were created, without the need to amend the treaty. When a new offense was created, the enacting statute merely had to add it to the 1989 Act list or make it an extraditable offense by another means.

Had the alleged offense been committed in the requesting state, extradition would be granted only if, according to the law of the requested party, evidence sufficient to justify the accused's committal for trial was

presented. In the case of requests by the US for extradition from the UK, this meant *prima facie* evidence was required.

In determining whether the dual criminality requirement was satisfied, the UK courts focused on the conduct that formed the basis of the offense rather than the precise crime with which the defendant was being charged in the US. There was no requirement that the US offense must also exist in the UK. Instead, dual criminality under the 1989 Act was understood as being satisfied whenever the conduct that formed the basis of the US offense would also constitute one of the listed extraditable offenses in the UK, even if the US and UK crimes were different.<sup>2</sup> This line of case law is likely to be applicable to the 2003 Act regime as well, such that the actual conduct of the defendant, and not the equivalence of the offense, will be determinative of whether the dual criminality test is met.

### B. The 2003 Act

#### 1. Overview

The 2003 Act, which repeals the 1989 Act, came into force on 1 January 2004. It applies to all extradition requests received from 1 January 2004, regardless of when the underlying conduct took place.

One of the main aims of the 2003 Act is to simplify the extradition process and ensure it works speedily. The complexity of the judicial system under the previous law had often led to long delays and, in some cases, it could take years for an extradition request to be processed. The list system that operated under the 1989 Act has been replaced with a simple threshold test. For extradition to certain countries (including the US), it provides that a defendant's conduct will be considered an extraditable offense if the conduct, which took place in the requesting state, would constitute an offense punishable with imprisonment or another form of detention for a term of at least 12 months under both the law of the relevant part of the UK and the law of the requesting state.<sup>3</sup>

#### 2. Extradition Procedure

The 2003 Act creates a new system whereby the UK's extradition partners are placed in one of two categories designated by the Secretary of State for the Home Department. One of the differences between the two categories is that in Category 1 cases, there is no executive involvement, whereas in Category 2 cases (the US has been designated a Category 2 jurisdiction), extradition decisions are reviewed by the Secretary of



State.<sup>4</sup> A country that retains the death penalty for any offense may not be designated a Category 1 jurisdiction.<sup>5</sup>

All extradition cases where the defendant is arrested in England or Wales are dealt with at Bow Street Magistrates' Court in London.<sup>6</sup> In Category 2 cases, following a decision by the Magistrates' Court that the individual should be extradited, the case goes to the Secretary of State. He must order the extradition within two months unless one of the following grounds applies:

- The person has been/could be/will be sentenced to death;<sup>7</sup>
- There are no specialty arrangements in force with the requesting territory (these ensure that the person extradited will only be dealt with for those matters in respect of which his extradition is ordered);<sup>8</sup> or
- If the person has been extradited to the UK they cannot be extradited to another country without the consent of the country from which they were originally extradited.<sup>9</sup>

Appeals against the decision of the Magistrates' Court and/or the Secretary of State go to the Administrative Court, a specialist section of the High Court. Notice of appeals must be given within 14 days of the decision and the Administrative Court must start to hear the appeal within 76 days of the notice. It is possible to appeal from the Administrative Court to the House of Lords, but this is only permitted if the Administrative Court certifies that the appeal involves a point of law of general public importance and either the Administrative Court or the House of Lords grants leave to appeal.<sup>10</sup>

### C. The New UK-US Treaty and the Requirement for Evidence

The UK and the US signed a new extradition treaty on 31 March 2003 (the "2003 Treaty").<sup>11</sup> The new treaty has been ratified by the UK, but has not yet been approved by the US Senate. Groups including the American Civil Liberties Union and the Irish-American group the Ancient Order of Hibernians have been lobbying against the treaty on Capitol Hill. Until the new treaty comes into force, the 1972 Treaty remains in effect.

Despite the failure of the US to ratify the new treaty, US prosecutors are already benefiting from its provisions in a number of important ways. In particular, the 2003 Treaty removes the requirement that the US has to establish a *prima facie* case against the accused when it seeks extradition; however, when the UK

requests the extradition of an individual from the US, it is still required to show probable cause. In December 2003, the British government took the step of giving effect to the substance of this part of the 2003 Treaty by including the US in an Order in Council (statutory instrument) under the 2003 Act, designating certain countries to which people could be extradited without evidence as from 1 January 2004.<sup>12</sup> The US, along with 41 other jurisdictions that were designated, need only provide information of the defendant's wrongdoing at the extradition hearing; it no longer has to adduce evidence showing that the defendant has a case to answer. This situation is at odds with Article 9 of the 1972 Treaty, which requires the requesting state to provide evidence sufficient for committal. If the US had not been designated in the Order in Council, this provision of the 1972 Treaty would still apply, as that treaty is still in effect.

## III. Extradition for Antitrust Offenses

### A. The Cartel Offense

Since 20 June 2003, with the entry into force of the competition provisions of the Enterprise Act 2002, price-fixing and other types of cartel behavior are criminal offenses in the UK.<sup>13</sup> Sections 188-202 of the Enterprise Act set out the "cartel offense," which provides for a criminal offense for individuals who dishonestly engage in cartel agreements, whether price-fixing, bid rigging, etc. Presumably, where price-fixing conduct has taken place after 20 June 2003, the UK cartel offense will serve as fulfilling the dual criminality requirement when the US seeks to extradite an individual for violations of Section 1 of the Sherman Act.<sup>14</sup> However, as discussed below, the judgment of the Magistrates' Court in the *Norris* case suggests that the fact cartel behavior was not a crime in the UK until 20 June 2003, will not prevent the extradition of individuals to the US for involvement in cartels prior to that date, where their conduct can be equated to the common law offense of conspiracy to defraud.

### B. The *Norris* Case

#### 1. Background

Ian Norris worked at the British engineering group, The Morgan Crucible Company plc, for nearly thirty years, becoming CEO in 1998 and retiring from the company in 2002. Morgan Crucible's North Carolina-based subsidiary, Morganite Inc., agreed in 2002 to pay \$10 million to settle charges by the DOJ of conspiring to fix the price of carbon products between 1990 and 2000.<sup>15</sup> Three Morgan Crucible executives negotiated plea agreements and were imprisoned in the US for their criminal obstruction to the DOJ investigation. Mr. Norris refused to plead and was arrested in Britain in January 2005 to face extradition charges under the 2003



Act. The DOJ alleges that between late 1989 and May 2000 Norris was party to a conspiracy with executives of competitor companies to fix the prices of carbon products sold in the US, and that Norris obstructed justice in connection with the related US grand jury investigation.

The conduct that gave rise to the US extradition request had taken place prior to involvement in a cartel constituting a criminal offense in the UK. Norris's lawyers argued that as price-fixing was not a criminal offense in the UK at the time of the alleged conduct, the dual criminality standard under the 2003 Act was not met. To establish dual criminality, the US therefore argued that the underlying conduct would have been punishable in the UK as common law conspiracy to defraud. In addition, the DOJ had the back-up of the two counts of attempting to pervert the course of justice by hiding evidence of the alleged cartel obstruction.

Whereas price fixing was not a crime in the UK at the time of the conduct, conspiracy to defraud was. The dual criminality test is not satisfied retrospectively, but defendants are liable to be extradited under the 2003 Act for an offense committed before 1 January 2004; the 2003 Act applies to all *requests for extradition* made from that date, regardless of when the conduct giving rise to the request occurred.

## 2. Judgment of the Magistrates' Court

Although cartel behavior has never been prosecuted as conspiracy to defraud in the UK, in a decision of 1 June 2005, District Judge Nicholas Evans had little difficulty deciding that, in theory, involvement in a cartel can amount to conspiracy to defraud. He held that "if such an agreement involves *dishonestly* doing something *prejudicial to another* the agreement will ordinarily amount to a common law criminal conspiracy to defraud." Dishonesty would frequently involve deception, but deception was not an essential element of the offense; and the judge held that, in cartel agreements, "prejudice to third parties is almost bound to be present."

The judge then considered if the offenses at issue were "extradition offenses," which depended on the nature of the alleged conduct. Norris had argued that the only conduct that could be considered by the court was that set out in the DOJ's indictment. Judge Evans disagreed, holding that he could consider the descriptions of Norris's conduct in the extradition request itself and was not limited solely to the indictment. The basis for this view was that, as many other Category 2 jurisdictions, in contrast to the US, "do not have narrative indictments" and so would provide a description of the conduct only in the extradition request, the court should be allowed to consider descriptions set out in documents other than the indictment in all cases. It

would be illogical "to suggest there should be one rule for American requests and a different rule for other requests."

Judge Evans went on to rule that both the price fixing and the obstruction of justice charges were "extradition offenses." He dismissed the argument that as dishonesty was not an element of the cartel offense under the Sherman Act, he should not consider the descriptions of Norris's dishonest conduct. He held that "[t]he so-called 'double criminality rule' does not require me to find a UK criminal offense to match the US offense. It requires a consideration of the defendant's conduct that has led to the foreign charge and then a determination as to whether that conduct, had it occurred in the UK, would amount to a UK offense carrying 12 months imprisonment or greater punishment." The judge concluded that since Norris's alleged conduct as a party to a "dishonest cartel" amounted to conspiracy to defraud, a UK offense carrying more than 12 months of imprisonment as punishment, the conduct amounted to an "extradition offense."

Similarly, Judge Evans held that Norris's alleged obstruction of justice was an "extradition offense." Norris argued that the court should consider only the alleged conduct and that an act, committed within the UK, alleging interference with or obstruction of a US federal grand jury, is not an offense known in English law. The judge was satisfied that in the context of the case, he was required to consider Norris's conduct, "had it occurred in the UK and had it been aimed at interfering with or obstructing a criminal investigation or judicial investigation taking place within the UK." Under this approach, the obstruction of justice allegations would have constituted a UK offense carrying imprisonment of 12 months or greater.

Judge Evans further rejected Norris's argument that his extradition would be unjust or oppressive given the passage of time since the alleged conduct took place. The court considered that the alleged offenses were still continuing as recently as six years ago and that Norris's own activity with regard to the alleged obstruction of justice could have had a delaying effect. The court found that Norris's deteriorating mental and physical health, while a factor, would not prevent extradition.

The court also rejected Norris's arguments that extradition would violate his right to a "private and family life" under Article 8 of the European Convention on Human Rights. In answer to the argument that there should not be a criminal trial in the US, he held that this was "very much an American case" and "[t]he fact that it might have been possible for criminal charges to be preferred against Mr. Norris in the UK is not a reason to deny jurisdiction to a state which has a very real and obvious reason to want to prosecute." Judge Evans

held that no “exceptional circumstances” making the extradition request a disproportionate and unjustified interference with the right to a family life were established.

### 3. Further Developments

On 29 September 2005, the Secretary of State ordered the extradition of Ian Norris under § 93(4) of the 2003 Act. At the time of writing, Norris’s appeal against the decisions of the District Judge and the Secretary of State is pending before the High Court in London. Norris will likely argue that the District Judge wrongly decided that the offenses specified in the extradition request were “extradition offenses” under the 2003 Act. In addition, he can be expected to argue that extradition should be barred because it would be unjust or oppressive by reason of the passage of time and that extradition would be incompatible with his rights under Articles 6 and 8 of the European Convention on Human Rights.

Norris’s High Court action has a second limb. In early 2005, Norris wrote to the Secretary of State, seeking a decision by him to remove the US as one of the countries designated as not having to provide *prima facie* evidence in extradition cases. The Secretary of State decided not to seek the removal of the designation and Norris has applied to the High Court for a judicial review of that decision, arguing that it is irrational. One of the central arguments here is that the continued designation of the US, as a country that does not have to supply *prima facie* evidence when making an extradition request in the UK, is inconsistent with the obligations of the UK under the 1972 Treaty, which remains in effect as the 2003 Treaty has not been ratified by the US.<sup>16</sup>

Arguments in the judicial review application were heard on 12 and 13 January 2006 and hearings in the appeal, which is before the same judges, are expected in March. Whatever decision the High Court reaches, it is likely that the case will be appealed up to the House of Lords.

### C. Implications of the Norris Case and Other Issues

The Norris case is the first in which the US has sought to extradite anyone for an antitrust offense, and given that it is under appeal, it is difficult to say what its ultimate implications will be. Nevertheless, the case has so far raised some interesting issues in the context of extradition from the UK to the US for antitrust offenses.

#### 1. The Use of the ‘Conspiracy to Defraud’ Offense

The fact that the cartel offense in the UK was not law at the time of Norris’s alleged conduct did not stop the Magistrates’ Court from finding that the conduct

would have constituted a criminal offense in the UK at the time. This was because in the opinion of the District Judge, the alleged conduct easily fit the elements of conspiracy to defraud, even though nobody has ever been prosecuted in the UK for cartel activity on that basis. Indeed, had the US sought to extradite Norris for price-fixing before 1 January 2004, it would not have been able to do so under the old extradition law, as conspiracy to defraud was not a listed extraditable offense. The retrospective application of the 2003 Act made the prosecution possible. Should Judge Evans’s ruling on this point be upheld on appeal, it would appear to open the door to the US to seek the extradition of other individuals who were involved in cartels before the coming into force of the 2003 Act. This could include executives such as Sir Anthony Tennant, the former chairman of Christie’s, who is wanted by US prosecutors for his involvement in the price-fixing cartel with Sotheby’s. Of course, for conduct that took place after the cartel offense was introduced in the UK (20 June 2003), that offense will likely be invoked to serve the requirement of dual criminality.

#### 2. The Long Arm of US Jurisdiction

The DOJ is clearly far more active in seeking criminal prosecutions for cartel activity than other antitrust enforcers. It also has a policy of seeking to ensure that, in every international cartel case, at least one foreign executive serves a term in jail. In contrast, the first criminal prosecution for cartel behavior in the UK has yet to take place, although the OFT now has the power to bring such prosecutions under the Enterprise Act. In international cartel cases, even if the UK authorities could take a criminal prosecution, and choose not to, this will have no effect on the DOJ’s ability to gain an extradition. Furthermore, there is no provision in the UK extradition laws that extradition can be declined where the crime is alleged to have taken place substantially in the territory of the UK.

Whereas the conduct at issue in the Norris case appears to have a genuine relationship to the US, given that it concerned allegations of fixing prices of goods sold in the US, the connection in other extradition cases may be less apparent. A case running roughly concurrent with that of Norris involves three ex-NatWest bankers against whom the US authorities are seeking extradition to face proceedings brought by prosecutors from the Enron Task Force for wire fraud. On 15 October 2004, Judge Evans, who also heard their case at Bow Street Magistrates’ Court, sent the case to the Secretary of State, who ordered the extradition of the three. The case is currently under appeal. The defendants are all UK citizens who worked in the UK and who are accused of defrauding their former UK employer, NatWest. As part of their efforts to avoid extradition, they are taking the interesting step of seeking a judicial

review of the Serious Fraud Office's decision not to prosecute them. Had they been prosecuted in the UK, then extradition to the US for offenses arising out of the same conduct would not have been a possibility, as it would have been barred by the rule against double jeopardy contained in § 80 of the 2003 Act.

The apparent willingness of US prosecutors to take actions against financial crime, even when there is only a peripheral connection to the US,<sup>17</sup> coupled with the fact that UK enforcers may be less assertive in prosecuting white-collar crime, means that extradition to the US has become a more likely prospect for executives based in the UK. Certainly the statistics concerning requests by the US under the 2003 Act regime would seem to bear this out. Figures released by the Home Office in April 2005 showed that of 43 requests for extradition made by the US under the 2003 Act, 22 related to white-collar crime charges.

#### IV. Conclusion

Should the DOJ be successful in having Ian Norris extradited to the US, it will be a major boost to its campaign of prosecuting international cartels. It can be expected that the DOJ will continue aggressively to seek to identify appropriate cases in which to pursue the extradition of non-US executives on cartel-related charges. The case also raises broad questions about the current extradition regime between the UK and the US and how it applies to antitrust cases. Ultimately, it can be expected that the case will come before the House of Lords, and until then, the fate of other executives who are likely targets of an extradition request by the DOJ, will remain, to some extent, uncertain.

#### Endnotes

1. Extradition Act 2003, available at <http://www.opsi.gov.uk/acts/acts2003/20030041.htm>.
2. See, e.g., *R. v. Governor Metropolitan of Ashford Remand Center, ex parte Postlethwaite* [1988] A.C. 924; *R. v. Bow Street Metropolitan Stipendiary Magistrate, ex parte Government of the United States of America* [2000] A.C. 216.

3. See 2003 Act § 137.
4. The procedure for arrest, extradition hearings, appeals, etc. is broadly similar under both categories; however, Category 1 cases benefit from the advantages of the European Arrest Warrant, and so are more straightforward.
5. *Id.* § 1(3).
6. *Id.* § 139.
7. *Id.* § 94.
8. *Id.* § 95.
9. *Id.* § 96.
10. *Id.* § 114.
11. Extradition Treaty between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America, 31 March 2003, available at [http://www.fco.gov.uk/Files/kfile/USExtradition\\_210503.pdf](http://www.fco.gov.uk/Files/kfile/USExtradition_210503.pdf).
12. Extradition Act 2003 (Designation of Part 2 Territories), Order 2003 (S.I. No 3334).
13. Enterprise Act 2002, available at <http://www.opsi.gov.uk/acts/acts2002/20020040.htm>.
14. Though no longer applicable since the 2003 Act entered into force, § 191 of the Enterprise Act had added the cartel offense, or a conspiracy or an attempt to commit it, as an extradition offense to which Schedule 1 of the 1989 Act applied.
15. Disclosure: Sullivan & Cromwell LLP represented the Morgan companies in the US investigation and ensuing class action litigation.
16. A similar judicial review application in Scotland was recently dismissed in a judgment of the Outer House of the Court of Session (*Calder, Re Application for Judicial Review* [2005] ScotCS CSOH 125 (20 September 2005)).
17. See, e.g., *Pasquantino v. United States*, 125 S. Ct. 1766 (2005) (US Supreme Court upheld the conviction of three participants in a scheme to defraud Canada of alcohol import taxes and duties by smuggling liquor from the US into Canada, despite the common law revenue rule that bars enforcement in US courts of foreign revenue laws; the three were convicted of breaching the federal wire fraud statute (18 U.S.C. § 1343), which prohibits the use of interstate wires such as telephone, e-mail or mail to carry out a scheme to defraud).

**Robert M. Osgood is a partner and Nathy J. Dunleavy is an associate in the London office of Sullivan & Cromwell LLP.**

# Workers Abroad, Trouble at Home: Multinational Employers Face Growing Liability for Labor Violations of Overseas Suppliers

By Aaron J. Schindel and Jeremy Mittman

## I. Introduction

Wal-Mart is the world's biggest company and the world's largest private employer. A company that employs approximately 1.7 million employees can expect more than a few employment suits to be brought against it in any given year. It is not a complete surprise, therefore, that this company was socked with a class action employment lawsuit in September, 2005. What was surprising was *who* brought the suit: not Wal-Mart's own employees, but a rather putative class of employees who work for overseas companies that supply products to Wal-Mart.

In *Jane Doe I v. Wal-Mart Stores Inc.*,<sup>1</sup> attorneys representing employees of Wal-Mart's suppliers in Bangladesh, Indonesia, Swaziland, and Nicaragua filed suit in California state court, seeking to hold Wal-Mart liable for its suppliers' allegedly substandard labor conditions. The theory of the complaint is that Wal-Mart, having reserved the right to monitor its suppliers' compliance with labor laws, breached a contract with its suppliers' employees when it failed to enforce its standards with sufficient vigor and that it then made false and deceptive statements to the American public about its compliance with labor standards.

Wal-Mart is just the latest U.S.-based multinational giant to be sued by employees of foreign companies that manufacture goods for American corporations. An even greater number of multinationals have been sued by their own employees working in foreign countries. For instance, the New York-based maker of Perry Ellis clothes settled a Texas lawsuit over an employee benefit it offered to its Mexican employees. Chiquita and Dole were sued in Texas by thousands of sterile banana-pickers located in Africa, Asia, and Latin America. While these cases raise a host of legal issues on their own, a company that fails to comply with the local labor laws in any country should expect that it is going to find itself in trouble.

But what about Wal-Mart? If a foreign company fails to comply with the labor laws of its home country, should Wal-Mart be faulted? Or should the company that actually employs the workers be liable? Moreover, even if Wal-Mart can be sued under a legal theory or theories of liability for its overseas suppliers, it is legiti-

mate to wonder why Wal-Mart should be sued in America: If workers in Bangladesh are alleging violations of Bangladeshi labor law by their Bangladeshi employer, shouldn't the case proceed in Bangladesh? As more companies seek to outsource their manufacturing or services abroad, the risk of liability for the actions of their suppliers or contractors is becoming a growing concern.

For several years, domestic labor organizations seeking to halt the flow of jobs overseas and non-governmental organizations seeking to create a body of international labor law have been trying to find or develop a body of law that would give American courts jurisdiction over the foreign facilities providing goods or services for U.S. companies. Several recent cases highlight the emerging theories of liability under which U.S. companies can be held liable for the substandard labor conditions of their suppliers overseas. So far, the plaintiffs have been more successful in prying settlements out of multinational corporations than in forming a cohesive theory of liability. In much the same way that courts in the last century developed the body of products liability law to find a remedy for persons injured by harmful products introduced in the stream of commerce, so too it might be said that international labor and human rights organizations are searching for a theory of liability to hold multinationals with deep pockets liable for employees around the world who work in allegedly injurious conditions.

## II. Emerging Theories of Liability to Hold U.S. Companies Accountable for the Labor Conditions of their Subcontractors and Suppliers Abroad

### A. Application of the Alien Tort Claims Act to U.S. Companies for Substandard Labor Conditions Overseas: the *Unocal* Case

The Alien Tort Claims Act ("ATCA"), 28 U.S.C. § 1350, may provide American courts with the necessary extraterritorial reach that would permit workers in the global market to bring legal actions against companies for substandard labor conditions. The formerly obscure ATCA was originally passed by the first Congress in 1789 and is thought to have been enacted to address piracy. It provides that "[t]he 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.” Thus, in order to invoke a cause of action under the ATCA, an alien must make a claim alleging a tort that violated international law.

Largely dormant for many years, the ATCA was revived in 1980 by the Second Circuit’s decision in *Filaritiga v. Pena-Irala*.<sup>2</sup> In *Filaritiga*, the plaintiffs were Paraguayan citizens living in the United States who sued a Paraguayan police official who was also present in the United States (awaiting deportation), claiming that he had tortured and murdered their family member in Paraguay. The Second Circuit held that the Paraguayan aliens could bring a tort claim against the foreign defendant for a violation of customary law, even though the alleged tort did not occur on U.S. soil and did not implicate U.S. citizens or U.S. national interests, but actually involved another country’s treatment of its own citizens.<sup>3</sup> Accordingly, this case established that U.S. federal courts are permitted to adjudicate certain rights already recognized by international law.

More recently, the ATCA has been used by plaintiffs against U.S. corporations that they claim are knowingly complicit in human rights violations. In 1996, beginning with a case filed against Unocal Corporation for allegedly benefiting from the use of slave labor to construct a natural gas pipeline in Burma (now Myanmar), a series of cases have been brought under the ATCA, alleging that global companies have knowingly participated in human rights violations.<sup>4</sup>

In *Doe v. Unocal*,<sup>5</sup> the plaintiffs were Burmese citizens who alleged that the Burmese government had used forced labor, rape, torture, and murder to compel them to help build a pipeline through rural communities in Burma to benefit a Unocal facility. Unocal maintained that it had no control over the actions of that country’s military, and the central issue in the case was whether the company could be held liable under the ATCA or the Racketeer Influenced and Corrupt Organizations Act (“RICO”) statute for a foreign government’s alleged abuse of its own citizens.

A Ninth Circuit panel originally held that the company could be liable under the ATCA for aiding and abetting the actions of the military through “knowing practical assistance, encouragement, or moral support which has a substantial effect on the perpetuation of the crime.”<sup>6</sup> With respect to the RICO claim, however, the court accepted the argument that allegations of forced labor could form the underpinnings of an extortion claim under RICO, but it affirmed the decision of the district court that RICO should not be applied extrater-

ritorially and that Unocal’s providing financial and technical support for the pipeline did not directly cause the plaintiff’s injuries.

The Ninth Circuit subsequently granted a petition for *en banc* review of the *Unocal* case, to determine whether aiding and abetting was applicable to ATCA claims. But before the *en banc* court could render a decision, the case settled.

In response to the revival of the ATCA as a potential cause of action, the Bush Administration attempted to intervene, arguing that lawsuits of this kind interfere with foreign policy and open multinational companies to frivolous or irrelevant grievances that, if they should be litigated at all, should be brought in the foreign plaintiffs’ own fora.<sup>7</sup> Additionally, the business community has attempted to prevent the application of the ATCA to corporations, arguing that the broad scope of international law will make it impossible for well-intentioned companies to know what conduct might subject them to liability.

The attempt by the Bush Administration and the business community to halt the use of the ATCA achieved some measure of success as a result of the Supreme Court’s decision in *Sosa v. Alvarez-Machain*.<sup>8</sup> The *Alvarez* case was the first time that the Supreme Court was presented with the opportunity to consider the application of the ATCA. In *Alvarez*, the U.S. Drug Enforcement Agency (“DEA”) was alleged to have conspired with Mexican nationals to abduct Dr. Alvarez-Machain in Mexico and bring him to the United States, where he would face trial for his alleged role in the torture and killing of a DEA agent. The trial court dismissed the case against Dr. Alvarez-Machain, finding that there was not enough evidence to try him for torture and murder. After his acquittal, Alvarez-Machain sued under the ATCA for his kidnapping in Mexico, and prevailed. The Ninth Circuit Court of Appeals upheld the award, and the defendant sought review by the Supreme Court, primarily arguing that the ATCA did not authorize a private right of action. The Supreme Court found that a private right of action existed under the ATCA, but declared that the only types of claims that individuals could bring suit under that statute were “for a relatively modest set of actions alleging violations of the law of nations.”<sup>9</sup> The Court advised that the lower courts should proceed cautiously, and only recognize those types of claims that were universally recognized as violations of the law against nations, such as piracy was recognized to be a violation in the eighteenth century. With respect to the case before it, the Court found that “a single illegal detention of less than a day, followed by the transfer of custody to lawful authorities and a prompt arraignment, violates no norm of customary international law so well defined as to

support the creation of a federal remedy [under ATCA].”<sup>10</sup>

Both employee rights organizations and multinational corporations have claimed victory after the *Alvarez* decision. Employee organizations pointed to the Supreme Court’s pronouncement that they could bring a claim under the ATCA, and multinationals touted the Court’s limiting language in the decision. The issue now for a company such as Wal-Mart is whether the failure to monitor its suppliers according to values espoused in its own code of conduct will be deemed a violation of international norms and, thus, the “law of nations.” The Supreme Court’s decision in *Alvarez* probably forecloses such a theory, although there have not been any court rulings yet.

The problem for labor rights groups is that it is unlikely that a mere violation of labor standards could rise to the level of a violation of the “law of nations” or an international treaty, as is required by the ATCA as interpreted by the Supreme Court. Plaintiffs could try to point to such international labor standards as the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work<sup>11</sup> and an employer’s corresponding violation of its provisions, and argue that the employer has violated the “law of nations,” but the Supreme Court has said that “federal courts should not recognize private claims under federal common law for violations of any international law norm with less definite content and acceptance among civilized nations than the historical paradigms familiar when [the ATCA] was enacted.”<sup>12</sup> Consequently, plaintiffs would face an uphill battle in convincing a court that labor violations are as an accepted violation as the limited claims that were accepted in 1789. The *Wal-Mart* plaintiffs did not even raise an ATCA claim in their complaint.

As more cases under the ATCA are brought against U.S.-based multinational employers, after *Alvarez* the boundaries of the ATCA are likely to become more defined. A recent case in the Eleventh Circuit sheds some light on where these boundaries might be drawn. In *Villeda-Aldana v. Del-Monte Fresh Produce, N.A., Inc.*,<sup>13</sup> one of the first cases to be decided after *Alvarez*, the Eleventh Circuit held that the plaintiffs, former union leaders in Guatemala, could proceed with their claims of torture under the ATCA but their ATCA claims of physical pain and suffering through pushing and shoving, cruel and inhuman punishment, and arbitrary detention could not proceed. Thus, it may very well be the case that a claim against a multinational company under the ATCA may not survive a motion to dismiss unless the company can be accused of actually engaging in the torture (or committing some other gross human rights violation) of employees (either its own or its suppliers’).

## B. Civil RICO and Unfair Business Practices

In January 1999, three class action suits were filed against numerous major clothing manufacturers, including Gap and The Limited. The suits were filed, in part, on behalf of alien workers in Saipan, an island in the Commonwealth of the Northern Mariana Islands, which is an American territory. Due to this relationship, the companies producing clothing in Saipan have been able (in fact, required) to label their garments as “Made in the USA.”<sup>14</sup> However, although this unique relationship requires the manufacturers to follow federal labor laws, the local government has retained control over immigration, customs, and minimum wages. As such, Saipan is exempt from U.S. minimum wage and immigration laws.

The suits were filed under RICO and the ATCA. The suits alleged that fifty-five retailers and the factories that actually made the garments were knowing and active participants in a scheme to exploit thousands of workers. Additionally, four labor and human rights organizations (UNITE, Sweatshop Watch, Asian Law Caucus, and Global Exchange) filed state court actions in California Superior Court,<sup>15</sup> alleging that the manufacturers and retailers committed unfair and unlawful business practices under the California Business & Professions Code by allegedly selling “hot goods” manufactured in Saipan in alleged violations of U.S. labor laws, and by falsely advertising that the Saipan factories were effectively and adequately monitored by their American customers, the retail stores. Section 17200 of the California Unfair Competition Law (“UCL”) prohibits business practices that are “unlawful,” “unfair,” and “fraudulent” and also prohibits “unfair, deceptive, untrue, or misleading advertising.” Its sister statute, Section 17500, prohibits false and misleading advertising. California’s UCL allows government and private parties to initiate and prosecute actions and is unique because it permits plaintiffs to borrow other codes, statutes, regulations, and ordinances to create liability.

According to the lawsuit, Saipan factories hired foreign workers bound by “shadow contracts,” which allegedly restricted their fundamental rights of religion, association, and freedom from discrimination.<sup>16</sup> Moreover, the complaint alleged that the workers were subjected to inhumane living and working conditions on the island.

Several of the plaintiffs’ claims survived a motion to dismiss. In one of the first cases where plaintiffs had alleged RICO violations stemming from “sweatshop conditions,” the court found that the RICO statute, originally enacted with organized crime in mind, could be used to police employers who hired illegal aliens in a “racketeering manner.” In order to plead a RICO claim under 18 U.S.C. § 1962, a plaintiff must show that the

defendant engaged in a pattern of racketeering activity (such as the denial of wages and unlawful sweatshop conditions) and the existence of an enterprise. The court found that the plaintiffs had met this burden.<sup>17</sup>

After widespread reports in the media that generated negative publicity, the defendants eventually settled (in several waves). The settlements awarded financial compensation to the workers and also included the adoption of a code of conduct by the employers and retailers designed to ensure that the kinds of abuses that the plaintiffs alleged would not reoccur in the future. The case has been viewed by many labor rights organizations as a significant victory in their fight to hold companies liable for the overseas labor conditions of their suppliers. This situation is somewhat unique, however, due to Saipan's relationship with the U.S. and the resultant application of U.S. federal labor laws. But the Saipan case does lend credence to a private right of action against U.S. companies for their overseas suppliers' substandard labor conditions.

### C. Unfair Competition and False Advertising

Perhaps the most well-known case against a company sued for the practices of its overseas subcontractors is Nike, the world's largest shoe manufacturer. Like Wal-Mart, Nike does not own any of the factories where its shoes are produced. Nike has said that it is not in the business of making shoes, but marketing them. In an attempt to respond to charges, beginning in 1996, that its overseas suppliers operated "sweatshops" and the resultant negative publicity, Nike issued press releases, sent letters to the editors of various newspapers around the country, and sent letters to university presidents and athletic directors. Additionally, in order to demonstrate that it did not mistreat or underpay workers, Nike commissioned a report by former Ambassador to the United Nations, Andrew Young. Young reported no evidence of the widespread substandard labor conditions which were alleged against the Nike factories.

In April 1998, former athlete, labor rights activist, and California resident Marc Kasky filed suit against Nike alleging unfair and deceptive practices under California's Unfair Competition Law and False Advertising Law. It was asserted that, "in order to maintain and/or increase its sales," Nike made numerous "false statements and/or material omissions of fact" concerning the working conditions under which Nike products are manufactured.<sup>18</sup> Thus, the essential claim was that Nike misled the public when it denied that its overseas subcontracting factories were mistreating and underpaying workers.

The California Court of Appeals dismissed the suit against Nike and held that the company's statements were part of a public dialogue on a matter of public

concern and were thus protected speech within the meaning of the First Amendment. On appeal, however, the California Supreme Court reversed and reinstated the case. The court held that "[b]ecause the messages in question were directed by a commercial speaker to a commercial audience, and because they made representations of fact about the speaker's own business operations for the purpose of promoting sales of its products, . . . [the] messages are commercial speech."<sup>19</sup> The Supreme Court of the United States granted certiorari. However, on 26 June 2003, the Supreme Court dismissed the writ of certiorari as improvidently granted.<sup>20</sup> Faced with costly litigation in order to avoid liability for its statements addressing the alleged substandard labor conditions of its overseas subcontractors' facilities, Nike agreed to settle the suit in 2003. As part of the settlement, Nike agreed to contribute to worker development programs and to an independent monitoring organization.

### III. *Doe v. Wal-Mart: Breach of Contract and Unfair Competition*

The suit recently filed against Wal-Mart is a mix of old and new strategies. Like the *Nike* case, counsel for the plaintiffs (the same counsel who forced Unocal to settle) allege that Wal-Mart has presented a polished image of its suppliers' compliance with international labor standards, but that its supplier's egregious violations, and Wal-Mart's failure to enforce its declared labor standards, constitute misleading statements that render it liable under California's unfair business practices law. The Wal-Mart plaintiffs, however, have deployed an apparently novel strategy by basing their allegations on Wal-Mart's alleged noncompliance with its own code of conduct for suppliers. Wal-Mart insists that all of its suppliers sign and adhere to its "Standards for Suppliers," which requires them to comply with applicable labor laws and gives Wal-Mart the right to monitor their compliance and to discontinue their services if violations are found. The plaintiffs allege that Wal-Mart breached its contract with them by failing to monitor adequately its suppliers, and by failing to penalize the suppliers harshly enough when it did find serious violations. Responding to the suit, Wal-Mart has countered that, last year, two hundred inspectors made twelve thousand monitoring visits and that, "if a violation is observed, Wal-Mart works constructively with suppliers so their factories correct the problems. We discontinue business with them if they fail to change their practices."<sup>21</sup> It remains to be seen whether the courts will accept the notion that corporate guidelines and codes of conduct constitute legally enforceable contracts and, if they do, that the employees of foreign contractors can sue in American courts to enforce these guidelines and codes.



Whether Wal-Mart has adhered to its code of conduct is a factual matter, but the *Wal-Mart* case will surely be watched by every multinational corporation that has enacted a code of conduct. If every corporation that has enacted such standards—likely thought by most corporations to be merely “aspirational” in character—can be held liable for failing to enforce its standards, corporations can expect many lawsuits to be forthcoming. Presumably, companies will begin to include disclaimers in their codes and standards, seeking to head off potential liability, along with forum-selection and mandatory arbitration clauses, to keep these claims out of the hands of American juries. We can look forward to a decade or more of fierce litigation before these legal issues will be resolved.

## Endnotes

1. Cal. Super. Ct. No. BC339737 (complaint filed 13 September 2005).
2. 630 F.2d 876 (2d Cir. 1980).
3. *Id.* at 880.
4. In addition to Unocal, suits were brought against Exxon-Mobil Corp., Coca-Cola Co., Del Monte Fresh Produce, N.A., Inc., Drummond Co., and DaimlerChrysler Corp.
5. 403 F.3d 708 (9th Cir. 2005).
6. *Doe v. Unocal*, 395 F.3d 932, 951 (9th Cir. 2002).
7. Forero, *Rights Groups Overseas Fight U.S. Concerns in U.S. Courts*, N.Y. TIMES, 26 June 2003, at A3 (hereinafter “Forero”).
8. 542 U.S. 692, 124 S.Ct. 2739, 159 L.Ed. 2d 718 (2004).
9. *Id.* at 720, 124 S.Ct. at 2759, 159 L.Ed. 2d at 746.
10. *Id.* at 738, 124 S.Ct. at 2769, 159 L.Ed. 2d at 757.
11. Available at: <http://www.ilo.org/dyn/declaris/DECLARATIONWEB.INDEXPAGE>.
12. *Sosa v. Alvarez-Machain*, note 8 *supra*, 542 U.S. at 732, 124 S.Ct. at 2765, 159 L.Ed. 2d at 753.
13. 416 F.3d 1242 (11th Cir. 2005).
14. Oreskovic, *Sweatshop Case Certified as a Class Action*, BROWARD DAILY BUSINESS REVIEW, 21 May 2002 at A7 (hereinafter “Oreskovic”).
15. Plaintiffs’ Memorandum of Points and Authorities in Support of Motion For Final Settlement Approval, *Doe v. The Gap, Inc.*, 20 March 2003 (No: CV-01-0036) (hereinafter “Plaintiffs’ Memorandum”).
16. Oreskovic, note 14 *supra*, at A7.
17. *Does I v. The Gap, Inc.*, 2002 WL 1000068, at 10 (D.N. Mar. I. 10 May 2002).
18. *Nike, Inc. v. Kasky*, 539 U.S. 654, 656, 123 S.Ct. 2554, 2554-2555, 156 L.Ed. 2d 580, 580-581 (2003).
19. *Kasky v. Nike, Inc.*, 27 Cal. 4th 939, 946, 119 Cal. Rptr. 2d 296, 300-301, 45 P.3d 243, 247 (2002).
20. *Nike, Inc. v. Kasky*, 539 U.S. 654, 123 S.Ct. 2554, 156 L.Ed. 2d 580 (2003). Justice Stevens cited three reasons for dismissing the appeal: (1) the judgment entered by the California Supreme Court was not final within the meaning of 28 U.S.C. § 1257; (2) neither party has standing to invoke the jurisdiction of a federal court; and (3) the reasons for avoiding the premature adjudication of novel constitutional questions apply to this case.
21. Greenhouse, *Wal-Mart Questions Motives of Lawsuit by Labor Group*, NEW YORK TIMES, 16 September 2005, at C6.

**Aaron J. Schindel is a partner, and Jeremy Mittman is an associate, in the Labor and Employment Law Department of Proskauer Rose LLP in New York.**

# United States Patent Protection for Computer Software

By L. Donald Prutzman

## I. Introduction

Twenty-five years ago, patents were generally not considered a realistic source of intellectual property protection for computer programs, or “software,” under United States patent law. Software was thought not to be patentable subject matter. In *Gottschalk v. Benson*,<sup>1</sup> the United States Supreme Court had disallowed a patent for an invention based on a computer program. The Court refused to recognize patents that included computer algorithms without express authorization from Congress. The United States Patent Office adopted an expansive view of *Gottschalk* that essentially ruled out software patents. Registration of the copyright in software was viewed as the most likely avenue for intellectual property protection.

Today, the situation is dramatically reversed. Over the past twenty-five years in the United States the efficacy of copyright protection for software has waned considerably, and the availability of patent protection for software has increased dramatically. In the United States today, patents are the preferred method of intellectual property protection for new innovations accomplished through computer software. Copyright protection is considered narrow and relatively ineffective.

In most developed countries, including European countries, this is not yet the situation. Patent protection for computer software is still limited and in many cases software is specifically barred as potential subject matter of a patent. Whether other countries, or the European Union as a whole, should move in the direction of the United States is a controversial subject. This article will provide an overview of United States patent protection for software and its development.

## II. Why Patent Protection for Software Is Desirable

Before discussing the development of United States patent protection for software, it is important to understand what patents protect, why patent protection is valuable, and how patents compare to other forms of intellectual property protection. A United States patent gives its owner a monopoly—the right to exclude others from making, using or selling the patented invention.<sup>2</sup> The patent monopoly lasts for twenty years from the filing of the application under current law.<sup>3</sup>

In contrast, copyright protection for software lasts much longer—the author’s life plus seventy years, or

ninety-five years from publication where a business entity is the “author,”<sup>4</sup>—but the protection is not a monopoly and gives no right to exclude others from exploiting whatever innovation the software involves. A software copyright covers only the author’s particular expression of the innovation.

Consider, as a concrete example, the patent controlled by Amazon.com, US Patent No. 5,960,411, for its “one-click” software for a method of completing an online purchase with a single mouse click using a combination of a cookie on the customer’s system and a database of customers on the vendor’s system. Software to perform essentially that innovation could be written in a number of alternative ways. However, the patent protects not only Amazon.com’s particular software, but all ways to accomplish “one-click” on-line purchasing in that manner. Assuming the patent is valid (a litigable issue, as noted below), no one else can offer it, even with radically different software.

In contrast, the copyright in the software only gives Amazon.com the right to prevent others from using substantially similar software. Using any of many possible differently written computer programs to accomplish “one-click” purchasing would not infringe the copyright. However, using any software to do so via the patented method would infringe the patent. Of course, the copyright lasts much longer. But the patent’s protection is broader and potentially far more commercially valuable. And in today’s fast-paced technological world, the twenty-year term of a patent is essentially an eternity—most often longer than the useful life of the software.

The trade-off for the monopoly a software patent grants is the requirement that the patent application fully and publicly disclose the invention. It must be disclosed in a manner sufficient to enable one skilled in computer technology—a computer geek, for example—to recreate it, even though he or she is not allowed to use the invention during the patent term.<sup>5</sup> A software patent that is not “enabling” is not valid and cannot be enforced. The idea behind the requirement is to promote the progress of science and technology by allowing others to build on the innovations of predecessors, even though the innovations may not be available during the life of the patent.

### III. The Evolution of Software Patent Protection in the United States

Patent law must inevitably evolve because it is constantly dealing, as it must, with the cutting-edge of the state of the art. Computer software is a prime example of how innovation challenges the system and forces it to evolve as a result.

#### A. The Legal Basis for Patent Protection

United States patent protection is rooted in the Constitution. Article 1, § 8, cl. 8 states that, “The Congress shall have power . . . [t]o promote the progress of science and useful arts, by securing for limited times to . . . inventors the exclusive right to their . . . discoveries.” That Constitutional grant supports Congress’ enactment of § 101 of the Patent Act,<sup>6</sup> which provides:

Whoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.

Section 101 thus specifies what subject matter may be granted a patent—a process, a machine, a composition of matter, or a manufacture. An invention cannot receive a United States patent unless it falls into one of these categories.<sup>7</sup> To receive a patent, an invention must also be useful, novel, *i.e.*, a new innovation,<sup>8</sup> and non-obvious, *i.e.*, not a readily apparent advance from prior inventions.<sup>9</sup>

#### B. Impediments to Patent Protection for Software

The basic problem that protection of computer software has posed for United States patent law has been how and where to shoehorn software into a category of patentable subject matter. Three formerly well-entrenched notions about the permissible subject matter of patents have made this difficult and contributed over the years to the delay in fully embracing computer software or software implemented inventions within the realm of patentable subject matter.

##### 1. The “Mathematical Algorithm” Exception

The first, and most important, is the idea that mathematical algorithms cannot be protected by a patent—the so-called “mathematical algorithm exception to patentability.” It has long been clear that certain things are “non-statutory” for purposes of patent protection, *i.e.*, *not* patentable because they are not statutory subject matter. These include “laws of nature,” “physical phenomena,” and “abstract ideas.”<sup>10</sup> Mathematical algorithms, the basis for computer software, were long

consigned to the category of “laws of nature,” putting software outside the scope of patentable subject matter.

##### 2. The “Mental Steps” Doctrine

A second impediment to patentability of computer software was the court-developed “mental steps” doctrine. The mental steps doctrine denied patent protection to inventions that relied on human intervention or calculations performed by humans. For example, in *In re Shao Wen Yan*,<sup>11</sup> the court affirmed the rejection of a patent claim because it involved mental steps to calculate the profile of an airplane wing with desired characteristics according to a mathematical formula.<sup>12</sup>

Computers, once developed, could be programmed with software to perform the calculations formerly performed by humans, and also, of course, sets of calculations far too complex or time consuming to be performed by humans for any useful purpose. Nevertheless, because computers performed calculations that humans could, in theory, perform, the mental steps doctrine stood as an argument against patentability of computer software. Because computers perform tasks that substitute for human mental steps or interaction, there seemed little difference between software and patents that could not survive the “mental steps” doctrine. Although no courts actually used the “mental steps” doctrine to deny patents to computer software, the idea that software merely did what humans would otherwise do inhibited the integration of software into patentable subject matter. In this connection, consider *Gottschalk v. Benson*,<sup>13</sup> which invalidated a patent for computer software for other reasons, but noted that computers operate on data and “solv[e] a problem by doing arithmetic as a person would do it by head and hand.”

##### 3. The “Business Methods Exception”

A third impediment to patentability of computer software was the so-called “business methods exception.” This doctrine was based on early cases holding that methods of doing business somehow fell outside the scope of patentable subject matter.<sup>14</sup> The doctrine seems to have been based on a general notion that a method of doing business, which did not produce a physical good or thing somehow could not be a process, machine, manufacture or composition of matter. Since computer software is often designed to accomplish results useful for a business purpose that does not produce a physical good, the prevalent belief that “methods of doing business” were not patentable inhibited the integration of software into the category of statutory subject matter for patents.

#### C. The Impediments Give Way

Gradually, these three impediments were eliminated.



## 1. “Mental Steps” Doctrine

The “mental steps” doctrine was the first to fall. In 1968, the Court of Customs and Patent Appeals (which, until its abolishment in 1982, when its function was replaced by the Court of Appeals for the Federal Circuit, heard appeals from Patent Office determinations), found that the precedents on which the “mental steps” doctrine was based were either poorly reasoned or had been misinterpreted over the years. This is the case of *In re Prater*.<sup>15</sup> The court concluded that the fact that a process may be performed mentally does not foreclose patentability if the claims reveal that the process also may be performed without mental operations, as they would be by a computer program. Subsequently, in the case of *In re Bernhart*,<sup>16</sup> the court reaffirmed *Prater* and indicated that all that remained of the mental steps doctrine was a prohibition on the granting of a patent that would confer a monopoly on all uses of a scientific principal or mathematical algorithm.

## 2. *Gottschalk v. Benson*

Courts next had to address the notion that granting a patent to a computer program would be tantamount to conferring a monopoly over a “law of nature” in the form of a mathematical algorithm. The Supreme Court began to struggle with the issue of whether computer software is patentable subject matter in 1972 in *Gottschalk v. Benson*.<sup>17</sup> That case considered an invention described as a method of programming a general-purpose digital computer to convert signals from binary-coded decimal form into pure binary form. The issue as the Court framed it was “whether the method described and claimed is a ‘process’ within the meaning of the Patent Act.” The Court held that the software was not patentable because it was a mathematical algorithm, described as “a generalized formulation for programs to solve mathematical problems of converting one form of numerical representation to another.”

*Benson* left in its wake doubt over whether the Court had closed the door to patentability of any computer software or merely software that was only a mathematical algorithm. The Patent and Trademark Office’s Board of Patent Appeals (which hears appeals from patent examiners’ rejections of patents) consistently took the position that *Benson* precluded the patentability of computer programs because they were based on algorithms. However, in a trio of cases, the Court of Customs and Patent Appeals reversed the Board and held that *Benson* only precluded patentability of mathematical algorithms, not other types of algorithms, and not all computer software.<sup>18</sup>

For example, in *Toma*, the court considered the patentability of a method of translating from one language to another using computers, and held that the software was not unpatentable subject matter because

the algorithm involved did not solve a mathematical problem, directly or indirectly. This confinement of non-patentability to mathematical algorithms, rather than all algorithms, still begged the question of whether software that relied on mathematical algorithms to conduct a process or accomplish useful results (and thus was arguably more than a *mere* mathematical algorithm) could meet the subject matter requirements for a patent.

## 3. *Parker v. Flook*

The Supreme Court next considered software patentability in 1978. In *Parker v. Flook*,<sup>19</sup> the Court rejected the patent in issue, but took pains to make clear that *Benson* did not stand for the proposition that computer software could never be patentable subject matter. The case involved a patent application for a process in which the only novel (and therefore potentially patentable) aspect was a mathematical formula implemented by computer programming. The Board of Patent Appeals had upheld the examiner’s rejection of the patent, but the Court of Custom and Patent Appeals reversed on the ground that useful post-solution applications of the formula made the process as a whole patentable. The Supreme Court held that because the post-solution applications were not novel, the patent must be rejected. The Court reasoned that, with nothing novel except the mathematical formula, granting the patent would amount to allowing a mathematical formula alone to be patentable, which would in effect constitute patenting a law of nature.

However, the Court expressly made clear that it was not holding that computer software could not be patentable subject matter:

Neither the dearth of precedent, nor this decision, should . . . be interpreted as reflecting a judgment that patent protection of certain novel and useful computer programs will not promote the progress of science and the useful arts, or that such protection is undesirable as a matter of policy.<sup>20</sup>

This represented a significant breakthrough.

Interestingly, in *Parker v. Flook*, the Commissioner of Patents, as the petitioner, had urged the Court to reject the patent on the grounds that upholding it would “require him to process thousands of additional patent applications” from the “rapidly expanding” computer software industry.<sup>21</sup> The demand for software patents was thus apparent.

## 4. *Diamond v. Diehr*

Three years later, in 1981, the Court actually upheld its first software patent in another breakthrough decision in *Diamond v. Diehr*.<sup>22</sup> The Court was split five to

four, with the majority opinion delivered by the late Justice (later Chief Justice) Rehnquist. The case involved the by then familiar scenario of a patent rejection by the Board of Patent Appeals based on a general hostility to the concept of software patents and its restrictive interpretation of *Gottschalk v. Benson*, followed by reversal by the Court of Custom and Patent Appeals, taking a more expansive view, and a petition for Supreme Court review by the Commissioner of Patents.

The disputed patent application was for a computer-implemented process for molding raw, uncured synthetic rubber into cured precision products. Curing synthetic rubber products is accomplished by heating the uncured rubber in a mold until it “cures” and holds the shape of the product. Opening the mold too soon or too late, however, results in an undercured or overcured product. The process sought to be patented involved constantly measuring the temperature inside the mold and feeding these measurements into a computer that repeatedly recalculates the cure time using a mathematical algorithm and then signals a device to open the mold at the optimum time. The Court held that the process could be the subject of a patent even though it was based on a computer implemented mathematical algorithm because the algorithm was being implemented or applied in a process that, considered as a whole, was performing a function designed to be protected by the patent laws. The Court reasoned that the applicant was not seeking to pre-empt all use of the mathematical formula, but only its use in conjunction with all the other steps in the process and that subject matter otherwise within § 101 does not fall outside that section simply because it uses a mathematical formula, computer program, or digital computer.<sup>23</sup>

The Court’s analysis continued:

In determining the eligibility of respondents’ claimed process for patent protection . . . their claims must be considered as a whole. It is inappropriate to dissect the claims into old and new elements and then to ignore the presence of the old elements in the analysis.<sup>24</sup>

This reasoning seems fundamentally inconsistent with *Parker v. Flook*, where the patent was, in effect, dissected and held invalid because the only “new” element was the algorithm, and the remainder of the process—the “post-solution activity”—was “old.” The decision attempted to explain the discrepancy by reasoning that in *Parker v. Flook* the post-solution activity was merely “token” and “the patent application did not purport to explain how the variables used in the formula were to be selected” or how the chemical process involved worked. From today’s vantage point, at least, the distinction seems less than convincing. In any event, *Dia-*

*mond v. Diehr* represented a significant turning point in the evolution of the United States patent system toward broad acceptance of patent protection for computer software and computer implemented applications that met the other patentability tests of utility, novelty and non-obviousness.

## 5. The Freeman-Walter-Abele Test

Following *Diamond v. Diehr*, the Federal Circuit purported to follow a two-part test for determining when a computer-implemented invention employing a mathematical algorithm was statutory subject matter. The test, which came to be known as the “Freeman-Walter-Abele” test,<sup>25</sup> has been described as follows:

It is first determined whether a mathematical algorithm is recited directly or indirectly in the claim. If so, it is next determined whether the claimed invention as a whole is no more than the algorithm itself; that is, whether the claim is directed to a mathematical algorithm that is not applied to or limited by physical elements or process steps. Such claims are nonstatutory. However, when the mathematical algorithm is applied to one or more elements of an otherwise statutory process claim, . . . the requirements of section 101 are met.<sup>26</sup>

The key factor on which a finding of statutory subject matter under this test turned became whether the process as a whole effected a transformation of some type. For example, *In re Alappat* held that an oscilloscope that employs mathematical algorithm to enable oscillator to convert discrete waveform data samples into output illumination data for display on screen was statutory.<sup>27</sup> *Arrhythmia Research Technology, Inc. v. Corazonix Corp.* claimed that process and apparatus for improved means of electronically measuring heart activity are statutory subject matter because resulting output is not an abstract number, but is a signal related to the patient’s heart activity.<sup>28</sup> The test was contrived and difficult to apply, and failed to give much clear guidance on whether particular computer-implemented inventions fell within § 101 of the Patent Act. However, the number of such patents granted was gradually increasing.

## IV. The Decline of Software Copyright Protection

Between 1981 and 1998, the preferred means of protecting computer software gradually began to shift from copyright to patents. During this period, there was a significant increase in patent applications for computer software-implemented inventions, and the Patent Office

began to relax its standards for issuing such patents. Further, the courts were upholding many more such patents.

During the same period, the courts were grappling with the application of copyright law to computer software and were gradually weakening the scope of copyright protection for software. In 1986, in *Whelan Associates, Inc. v. Jaslow Dental Laboratory, Inc.*,<sup>29</sup> the Third Circuit Court of Appeals established a relatively broad standard of copyright protection for software, holding that “copyright protection of computer programs may extend beyond the programs’ literal code to their structure, sequence and organization.”<sup>30</sup> The court reasoned that the majority of the creative effort in developing a computer program involves design rather than the technical coding of the software. For a while, a number of courts followed *Whelan’s* “structure, sequence and organization” test for copyright protection.

In 1992, however, the highly influential Second Circuit Court of Appeals rejected the *Whelan* test as overly simplistic and too generous in *Computer Associates International v. Altai, Inc.*<sup>31</sup> The court substituted a more restrictive three-part test for copyright protection of software known as “abstraction/filtration/comparison.” Application of the test involves analyzing the software at successive levels of abstraction, filtering out elements that are unprotectable because they were dictated by considerations other than creativity, required by factors external to the program, or taken from the public domain, and comparing whatever protectable expression is left to the defendant’s software to determine whether the protectable elements are substantially similar. The *Computer Associates* test has largely replaced the *Whelan* test, resulting in a decreased role for copyright in protection of software.

In the mid-1990s, the courts threw software copyrights a curve, and further weakened copyright protection for software. This came in the litigation between Lotus and Borland over whether Borland’s Quattro spreadsheet software infringed the “look and feel” of Lotus’ Lotus 1-2-3 spreadsheet software. After establishing that certain other spreadsheet programs infringed the graphic user interface (“look and feel”) of Lotus 1-2-3 in other litigation, Lotus sued Borland over Quattro because it believed that, although the graphic user interface was different, Quattro’s ability to interpret Lotus’ macros, following its menu hierarchy, infringed the copyright. The district court found infringement, *Lotus Dev. Corp. v. Borland Int’l, Inc.*,<sup>32</sup> and Borland appealed.

The First Circuit Court of Appeals reversed on quite unexpected grounds.<sup>33</sup> Borland argued that, under the *Computer Associates* test, its program was not “substantially similar” to Lotus’s. The court, however, found that substantial similarity was not really the issue.

Rather, it held for Borland on the ground that the menu command hierarchy was an uncopyrightable method of operation that could not be protected even if originality and creative choices were involved in the selection and arrangement of the commands in the hierarchy.

The Supreme Court heard the case, but, again to the surprise of the intellectual property community, it split four to four when one of the nine justices had to recuse himself, and the First Circuit decision was affirmed by an equally divided court.<sup>34</sup> Thus, the *Lotus v. Borland* litigation significantly weakened copyright protection for software.

The developments described above were a further impetus to the emergence of patents as the protection of choice for computer software.

## V. The Final Breakthrough

The watershed case that cleaned out the remaining cobwebs and opened the floodgates to software patents was the Federal Circuit’s 1998 decision in *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*<sup>35</sup> That this development came in private litigation over the validity of an issued patent, rather than in a dispute between the patent office and an applicant as in the prior cases discussed above, shows that software patents had been gaining greater acceptance and were being issued in greater numbers.

*State Street Bank* involved the validity of a patent issued in 1993 for a “Data Processing System for Hub and Spoke Financial Services Configuration.” The patent owner, Signature Financial Group, was an administrator and accounting agent for mutual funds. The patent covered a computer-implemented accounting system for mutual funds operated using a “hub and spoke” investment structure, meaning that each of a number of mutual funds (the “spokes”) pooled their assets in a single investment portfolio organized as a partnership (the “hub”) to provide economies of scale in administering the assets for the group of funds. The software enables the administrator to calculate necessary information such as the allocation of assets in the hub to the various spoke funds, the daily net asset values of the spokes, and the allocation of income, expenses, gains and losses to each fund.

State Street Bank was a competitor of Signature Financial in the business of mutual fund administration. After trying unsuccessfully to negotiate a license to use the patent, State Street sued Signature in the District of Massachusetts for a declaratory judgment that the patent was invalid and unenforceable and that its use of the accounting system it covered would not infringe Signature’s rights.<sup>36</sup>

The district court granted summary judgment for State Street, holding that the patent did not cover



“statutory” subject matter encompassed within § 101 of the Patent Act, discussed above, for two reasons: (1) that the patent merely claimed a mathematical algorithm; and (2) that it fell within the “business method” exception to patentability. Based on the law as it then existed, it is hard to fault the district court’s decision as erroneous. First, the software would seem to fall within the proscription of patentability for mathematical algorithms left by *Gottschalk v. Benson*, *Parker v. Flook*, and the Freeman-Walter-Abele test. It merely calculated numerical values like the software held unpatentable in *Gottschalk*. Unlike the patent in *Diamond v. Diehr*, the software did not produce some tangible, physical action as a result of its calculations, such as the opening of the rubber mold at the optimum time. In addition, the patent would seem to cover a method of “doing business,” then still recognized as an exception to patentability.

However, the Federal Circuit breezily reversed as though the district court should have known better than to apply existing law. The court first noted that the invention claimed was a “machine” (computer software running on a general purpose computer and peripheral devices), and not a “process” as the district court had interpreted it, but held that the type of subject matter made no difference as long as it fell somewhere within § 101.<sup>37</sup> Further, the court counseled against reliance on judicially created limitations on patentability under § 101, noting that Congress intended that section “to extend to ‘anything under the sun that is made by man.’”<sup>38</sup> The court then held that neither of the exceptions to patentability on which the district court relied applied to this case.

First, the court significantly limited the scope of the mathematical algorithm exception to patentability to situations in which the algorithm represents merely an abstract idea, stating that

Unpatentable mathematical algorithms are identifiable by showing they are merely abstract ideas constituting disembodied concepts or truths that are not “useful.” From a practical standpoint, this means that to be patentable an algorithm must be applied in a “useful” way.<sup>39</sup>

The court discarded the Freeman-Walter-Abele test as outdated, potentially misleading and having “little, if any, applicability to determining the presence of statutory subject matter.” It held that the hub and spoke accounting system at issue constituted not merely an algorithm, but a useful application of an algorithm:

[W]e hold that the transformation of data, representing discrete dollar

amounts, by a machine through a series of mathematical calculations into a final share price, constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces a “useful, concrete and tangible result”—a final share price momentarily fixed for recording and reporting purposes and even accepted and relied upon by regulatory authorities and in subsequent trades.<sup>40</sup>

The court also made short work of the business methods exception. It held that it was an “ill-conceived” exception that should be finally laid to rest,<sup>41</sup> and that “[w]hether the claims [of a patent] are directed to subject matter within § 101 should not turn on whether the claimed subject matter does ‘business’ instead of something else.”<sup>42</sup> In effect, the court said that the business methods exception never was the law and that the cases purportedly applying it were really based on other legal principles.

Thus, in one judicial decision, the court basically eliminated statutory subject matter as a hurdle for any computer-implemented invention that does something useful—even just calculating numbers for some purpose—and left the other conditions to patentability, such as novelty, non-obviousness and enabling disclosure, as the gatekeepers for software patents. The Supreme Court’s denial of a petition to review the case effectively made the Federal Circuit’s decision the law of the land unless Congress makes a change. That has been urged by some, but there is no reason to believe it is likely, even though the *State Street Bank* decision has not been universally acclaimed.<sup>43</sup>

## VI. The Aftermath of *State Street Bank*

Less than two months after the Federal Circuit rendered the *State Street Bank* decision, the United States Patent Office issued Patent No. 5,960,411 to Amazon.com for its one-click online shopping system. Within days, Amazon.com sued Barnes and Noble for infringement, alleging that the latter’s online shopping system infringed the one-click patent. In December 1999, the district court found infringement and issued a preliminary injunction.<sup>44</sup> Barnes and Noble appealed. In February 2001, the Federal Circuit vacated the injunction, finding that a serious question as to whether the patent was invalid for obviousness in light of the prior art made the preliminary injunction inappropriate.<sup>45</sup> Since that decision, the parties have settled the case on undisclosed terms. Significantly, whether the claims were directed to statutory subject matter was not even an issue. Clearly, software patents, particularly computer-implemented business method patents, are in full swing in the United States.

They are, however, controversial. For example, in March 2000, one author, writing for *The New York Times Magazine*, stated:

In ways that could not have been predicted even a few years ago, the patent system is in crisis. A series of unplanned mutations have transformed patents into a positive threat to the digital economy. The patent office has grown entangled in philosophical confusion of its own making; it has become a ferocious generator of litigation; and many technologists believe that it has begun to choke the very innovation it was meant to nourish.<sup>46</sup>

Another critic states:

The internet, considered to be the new frontier and land of the free, is actually being gobbled up parcel by parcel like the Oklahoma land rush where the “boomers” staked out Main Street in the prairie, except this “gold rush” should be called *State Street* for the case that has come to symbolize an open claim system, with little “invention” return to society, the basis of patent law.<sup>47</sup>

In all likelihood software and business methods patents will remain patentable in the United States at least to some extent. Indeed, the scope of what is patentable is currently continuing to expand. However, a case pending before the United States Supreme Court this term will address, and may reduce, the outer boundaries of patentable subject matter.

In late September 2005, in the case of *Ex Parte Lundgren*,<sup>48</sup> the Board of Patent Appeals held that business method patents are not even limited to processes that are implemented by computers, or, indeed, that involve any machine or technological arts whatsoever. In *Lundgren*, the patent examiner, following then-existing examination guidelines, had invalidated a patent claiming a method of determining compensation of a manager of a business designed to inhibit anticompetitive behavior in an oligopolistic industry. The method requires no manipulation of anything tangible, merely the determination of various performance parameters and the calculation of a compensation amount based on them. The examiner rejected the application for failure to meet a Patent and Trademark Office-created “technological arts” requirement, *i.e.*, that the concept of patentability inherently requires that some form of what is ordinarily considered science or technology be involved in the invention.

In a brief decision, the Board reversed the examiner and held that there is no “technological arts” requirement for the grant of a United States patent. In response to the Board’s decision, the PTO has recently changed its examination guidelines to eliminate any such requirement.<sup>49</sup> The *Lundgren* decision is not subject to further direct review because a losing examiner has no right to appeal.

Later this year, however, the Supreme Court will address the limits of patentable subject matter in *Laboratory Corp. of America Holdings v. Metabolite Laboratories, Inc.*,<sup>50</sup> and may set some boundaries. The *Laboratory Corp.* case, scheduled for argument on 21 March 2006, will consider whether the correlation of the results of a blood test with a vitamin deficiency diagnosis is patentable subject matter. The Federal Circuit held the patent valid in 2004 and the Supreme Court granted certiorari.

Because the patent is not directed to a device *per se*, but to the observation of a correlation between a blood test finding and a particular vitamin deficiency, some contend that the patent monopolizes an abstract idea or scientific principle and therefore stretches the limits of patentability too far. If the Supreme Court agrees, the case will provide an opportunity for the Court to roll back the scope of patent protection. Such a rollback, if it occurs, could affect the scope of patentability of business methods, many of which are implemented by computer software. It is doubtful, however, that the Court’s decision would eliminate computer software or business method patents altogether. If the Court upholds the patent, computer software and business methods will likely be solidly grounded in Supreme Court precedent as patentable subject matter.

## Endnotes

1. 409 U.S. 63 (1972).
2. 35 U.S.C. §§ 154(a), 271.
3. 35 U.S.C. § 154(a)(2).
4. 17 U.S.C. § 302.
5. 35 U.S.C. § 112.
6. 35 U.S.C. § 101.
7. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 483 (1974).
8. 35 U.S.C. § 102.
9. 35 U.S.C. § 103.
10. *See, e.g., Funk Bros. Seed Co. v. Kaloinoculant Co.*, 333 U.S. 127 (1948).
11. 188 F.2d 377 (C.C.P.A. 1951).
12. *See also In re Bolongaro*, 62 F.2d 1059 (C.C.P.A. 1933) (rejecting patent for method of determining number of pages of manuscript because the process involved human interaction); *Johnson v. Duquesne Light Co.*, 29 F.2d 784 (W.D. Pa. 1928) (patent for testing transmission wire insulation invalid because it used mental comparisons of operator).

13. 409 U.S. 63, 65-67 (1972).
14. See, e.g., *Loew's Drive-in Theatres v. Park-in Theatres*, 174 F.2d 547 (1st Cir.), cert. denied, 338 U.S. 822 (1949); *Hotel Security Checking Co. v. Lorraine Co.*, 160 F. 467 (2d Cir. 1908); *Berardini v. Tocci*, 190 F. 329 (C.C.S.D.N.Y. 1911).
15. 415 F.2d 1378 (C.C.P.A. 1968), mod. on rehearing, 415 F.2d 1393 (C.C.P.A. 1969).
16. 417 F.2d 1395 (C.C.P.A. 1969).
17. 409 U.S. 63 (1972).
18. *In re Toma*, 575 F.2d 872 (C.C.P.A. 1978); *In re Freeman*, 573 F.2d 1237 (C.C.P.A. 1978); *Application of Chatfield*, 545 F.2d 152 (C.C.P.A. 1976).
19. 437 U.S. 584 (1978).
20. *Id.* at 595.
21. *Id.* at 587-88.
22. 450 U.S. 175 (1981).
23. *Id.* at 186-188.
24. *Id.* at 188-89.
25. The name comes from a trio of earlier CCPA cases: *In re Abele*, 684 F.2d 902 (C.C.P.A. 1982); *In re Walter*, 618 F.2d 758 (C.C.P.A. 1980); *In re Freeman*, 573 F.2d 1237 (C.C.P.A. 1978).
26. *In re Schrader*, 22 F.3d 290, 292 (Fed. Cir. 1994).
27. 33 F.3d 1526, 1545 (Fed. Cir. 1994).
28. 958 F.2d 1053, 1058 (Fed. Cir. 1992).
29. 797 F.2d 1292 (3d Cir. 1986).
30. *Id.* at 1298.
31. 982 F.2d 693 (2d Cir. 1992).
32. 831 F. Supp. 223 (D. Mass. 1993).
33. *Lotus Dev. Corp. v. Borland Int'l, Inc.*, 49 F.3d 807 (1st Cir. 1995).
34. *Lotus Dev. Corp. v. Borland Int'l, Inc.*, 516 U.S. 233 (1996).
35. 149 F.3d 1368 (Fed. Cir. 1998), cert. denied, 525 U.S. 1093 (1999).
36. *State Street Bank & Trust Co. v. Signature Financial Group, Inc.*, 927 F. Supp. 502 (D. Mass. 1996), rev'd, 149 F.3d 1368 (Fed. Cir. 1998), cert. denied, 525 U.S. 1093 (1999).
37. 149 F.3d at 1372.
38. *Id.* at 1373, quoting *Diamond v. Chakrabarty*, 447 U.S. 303, 309 (1980).
39. *Id.*
40. *Id.*
41. *Id.* at 1375.
42. *Id.* at 1377.
43. Hulse, *Patentability of Computer Software after State Street Bank & Trust Co. v. Signature Financial Group, Inc.; Evisceration of the Subject Matter Requirement*, 33 U.C. DAVIS L. REV. 491 (2000) (arguing that *State Street Bank* was wrongly decided).
44. *Amazon.com, Inc. v. Barnesandnoble.com, Inc.*, 73 F. Supp. 2d 1228 (W.D. Wash. 1999).
45. *Amazon.com, Inc. v. Barnesandnoble.com, Inc.*, 239 F.3d 1343 (Fed. Cir. 2001).
46. Gleick, *Patently Absurd*, NEW YORK TIMES MAGAZINE, 12 March 2000 at \_\_\_\_.
47. Hoagland, *Web Patents: Owning a Piece of the Internet*, at <http://www.components-online.com/Software/Patents/default.htm>.
48. 76 U.S.P.Q.2d 1385 (Bd. of Patent Appeals 2005).
49. 71 Fed. Reg. 61 (3 January 2006).
50. 370 F.3d 1354 (Fed. Cir. 2004), cert. granted, 126 S. Ct. 601 (200\_).

**L. Donald Prutzman is a partner at Tannenbaum  
Helpern Syracuse & Hirschtritt LLP in New York, N.Y.**

**©2005 Tannenbaum Helpern Syracuse &  
Hirschtritt LLP.**



# Cross-Border M&A in India

By Vineet Aneja

## I. Overview

Over the past several years, the mergers-and-acquisitions market in India has been very active. In particular, the percentage of cross-border transactions has risen significantly. Cross-border deals have taken the form of both inbound and outbound transactions.

The growth in inbound transactions can be attributed to the growing interest of foreign companies in making acquisitions in India's information-technology and telecom sectors. It has been observed that overseas companies find it far more economical to acquire existing setups rather than opt for organic growth. On the other hand, outbound transactions, too, have increased significantly, with manufacturing companies acquiring entities overseas. It is evident that the appetite of Indian companies for making global acquisitions has grown bigger with time.

Every merger or acquisition involves one or more methods of obtaining control of a public or private company, and the legal aspects of these transactions include issues relating to due-diligence review, defining the parties' contractual obligations, structuring exit options, and the like. In India, the relevant laws that may be implicated in a cross-border merger or acquisition include the company law, the income tax law, the stamp duty act, the foreign exchange laws, competition laws, and securities regulations, among others.

Mergers and acquisitions are used as a means to achieve crucial growth and are becoming more and more accepted as a tool for implementing business strategy, whether they involve Indian companies wanting to expand or foreign companies wishing to acquire market share in India. Some of the other motivating factors behind mergers and acquisitions are the desire to acquire a competency or capability, to enter into new markets or product segments, to enter into the Indian market generally, to gain access to funding resources, and to obtain tax benefits.

## II. Applicable Indian Laws

### A. The Companies Act, 1956

The Companies Act, 1956<sup>1</sup> (the "Companies Act"), sets forth provisions relating to mergers and acquisitions. It also covers related issues, such as reorganizations, compromises and arrangements with creditors, and also becomes relevant while structuring an investment in a private-equity transaction (including matters relating to the type of shares and return available). Any number of the Companies Act's provisions may affect a

particular merger or acquisition. Procedures under the Companies Act are far from simple. Under the Companies Act, a merger (referred to in the Companies Act as an "amalgamation") is considered to be a scheme or arrangement<sup>2</sup> made with members<sup>3</sup> of a company. In any such scheme, both the amalgamating (i.e., merging) company or companies and the amalgamated (i.e., survivor) company are required to comply with the requirements specified in Sections 391 through 394 of the Companies Act, which, *inter alia*, require the approval of a "high court"<sup>4</sup> and of the Central Government. Sections 394 and 394A of the Companies Act set forth the powers of the high court and provide for the court to give notice to the Central Government in connection with an amalgamation of companies. It is not enough for only one of the companies alone to comply with the necessary statutory formalities.

While hearing the petitions of the companies in connection with the scheme of amalgamation, the court will give the petitioning company an opportunity to meet all the objections that may be raised by shareholders, creditors, the government and others. It is, therefore, necessary for the company to be prepared to face the various arguments and challenges that may be raised. Then, by court order, the relevant properties and liabilities of the amalgamating (i.e., transferor) company are transferred to the amalgamated (i.e., transferee) company and the amalgamating company is dissolved without undergoing the process of winding up.

The Companies Act's provisions governing amalgamation may be applicable to a cross-border amalgamation in a limited manner. Pursuant to Section 394(4)(b) of the Companies Act, the "transferee company" must be a company within the meaning of the Companies Act (i.e., an Indian company); however, a "transferor company" may be any body corporate, whether a company within the meaning of the Companies Act or not. A "body corporate" is defined in section 2(7) of the Companies Act to include a company incorporated outside India.

In the case of *Moschip Semiconductor Technology Limited*,<sup>5</sup> the High Court of the State of Andhra Pradesh, dealing with the amalgamation of an Indian company (as the transferee) and a foreign company governed by the laws of California (as the transferor), held that, under Section 1108 of the California Corporation Code and in contrast to the provisions of Indian law, the surviving company could be either a domestic company or a foreign company.<sup>6</sup> In the above matter, the court observed that "in these days of liberal globalization, a

liberal view is expected to be taken enabling such a scheme of arrangement for amalgamation between a domestic company and a foreign company and there is every need, in my considered view, for suitable modification of the law in that direction." The court also stated that a scheme involving a foreign and an Indian company would be subject to the laws of both countries. Notwithstanding the high court's dicta, currently in a merger or amalgamation of an Indian company and a foreign company, the transferee company (i.e., the surviving entity) must be an Indian company.

## **B. The Competition Act, 2002**

In the pursuit of globalization, India has opened up its economy, removing controls and resorting to liberalization. The natural corollary to this is that the Indian market needs to face competition from both within and outside the country. The Monopolies and Restrictive Trade Practices Act, 1969<sup>7</sup> (the "MRTP Act"), has become obsolete in certain respects in light of international economic developments relating to competition laws, and there is a need for India to shift its focus from curbing monopolies to promoting competition. In furtherance of the foregoing philosophy, the Government of India passed the Competition Act, 2002<sup>8</sup> (the "CA"), which seeks to ensure fair competition in India by prohibiting trade practices that cause an appreciable adverse effect on competition in markets within India. For this purpose, the CA provides for the establishment of a quasi-judicial body called the Competition Commission of India (the "CCI"), which also is empowered to undertake measures for the promotion of competition advocacy, creating awareness and offering training about competition issues.

The CA draws upon concepts of competition law found in more liberalized economies, such as those of the United States and the European Union. Of particular relevance to multinational companies operating in India is that the proposed new regulatory body, the CCI, will be empowered to scrutinize all mergers, acquisitions and joint-venture activity in India when the asset value of the parties involved is more than Rs. 10 billion within India or US \$500 million globally, or when sales are greater than Rs. 30 million within India or US \$1,500 million globally. The main components of the CA are the prohibition of anticompetitive agreements; the prevention of abuse by enterprises of their dominant positions; the regulation of mergers and acquisitions; the establishment of the CCI; and fixing the scope of the CCI's powers.

## **C. The Income Tax Laws**

As important corporate activities, mergers and acquisitions are also governed and regulated by provisions of the Income Tax Act, 1961<sup>9</sup> (the "IT Act"). The IT Act provides that the accumulated losses and unab-

sorbed depreciation of an amalgamating company (i.e., a company that does not survive a merger) shall be allowed in the assessment<sup>10</sup> of the amalgamated company (i.e., the company that survives a merger), provided, *inter alia*, that the amalgamating company owned an industrial undertaking, a hotel, or a ship; the amalgamated company holds at least three-fourths of the book value of the fixed assets of the amalgamating company for a minimum, continuous period of five years after the date of amalgamation;<sup>11</sup> and the amalgamated company continues the business of the amalgamating company for a minimum period of five years. Other incentives, like the set-off of depreciation and the treatment of expenditures for scientific research, the acquisition of patent rights or copyright, and expenditures for know-how, as well as the set-off of bad debts, are also envisaged in the IT Act for amalgamated and amalgamating companies.

An important aspect of any merger or acquisition is structuring the transaction so as to ensure the most tax-efficient structure. India has entered into treaties with various countries for the avoidance of double taxation. It has generally been observed that US investors, whether investing through private equity investment or by means of a direct acquisition, have used the Mauritius route for their investments in India.

## **D. The Indian Stamp Act, 1899**

The Indian Stamp Act, 1899,<sup>12</sup> provides for the levy of a stamp duty on the execution of an instrument. The stamp duty is applicable to an amalgamation (i.e., a merger) and to an acquisition, whether an asset or stock acquisition. Under the Indian Stamp Act, 1899, an "instrument" is defined to mean every document by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded. The applicability of the Indian Stamp Act to a stock acquisition depends on the form of the shares. If the shares exist in a physical form, the transfer of such shares is subject to a stamp duty at the prevailing rates. However, if the shares exist in a dematerialized form, no stamp duty is applicable for any transfer, thereof since such transfer is in the electronic form and does not require execution of any share transfer deeds. Section 108 of the Companies Act provides that there can be no registration of a transfer of shares in physical form without production of the certificate or allotment letter. Further, every instrument of transfer has to be duly stamped by an authorized person and executed by or on behalf of the transferor as well as the transferee. However, the Depository Act, 1996, provides that the formalities prescribed by Section 108 do not apply to any transfer of dematerialized shares between a transferor and transferee, both of whom are entered as beneficial owners in the records of a depository. Dematerialization is the process by which the physical certificates

of an investor, at his request, are taken back by the company and actually destroyed and an equivalent number of securities are credited in the electronic holdings of the investor. For this, the investor will have to first open an account with a Depository Participant (DP) and then request for dematerialization of his or her certificates through the DP so that the dematerialized shares can be credited to his or her account. The buyer is not required to apply to the company for registering the security in his or her name and thus no stamp duty is payable.

### E. Foreign Exchange Laws

Under Regulation 7 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000<sup>13</sup> (the "FEMA regulations"), once a scheme of merger, demerger or amalgamation has been approved by the court, the transferee company (whether the survivor or a new company) is permitted to issue shares to the shareholders of the transferor company who are persons resident outside India, subject to the condition that the percentage of nonresident holdings in the company does not exceed the limits for which approval has been granted by the Reserve Bank of India (RBI) or the prescribed sectoral ceiling under the foreign direct investment (FDI) policy set under the FEMA regulations. If the new share allotment exceeds such limits, the company will have to obtain the prior approval of the Foreign Investment Promotion Board (FIPB) and the RBI before issuing shares to the nonresidents. If the transferee company is engaged in a line of activity in which no foreign investment is permitted under India's FDI policy, then shares cannot be issued to the nonresidents.

In a similar vein, any acquisition of shares of an Indian company by a nonresident must comply with the foreign-exchange laws. Such an acquisition may be by way of subscribing to new shares or acquiring existing shares. Foreign investments in sectors or activities subject to the RBI's automatic route<sup>14</sup> do not require any prior approval of the FIPB. Under India's present FDI policy, any sale of shares from a resident to a nonresident (and vice versa) is permitted under the RBI's automatic route, provided certain conditions (*inter alia*, those relating to pricing) are complied with.

### F. Securities Laws of India

In India, takeovers and acquisitions are governed by SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997,<sup>15</sup> popularly known as the "Takeover Code." These regulations seek to regulate the whole process of acquisition and takeovers, based on principles of transparency, fairness and equal opportunity for all. The Takeover Code lays down the procedures governing any attempted takeover of a company whose shares are listed on one or more recognized stock exchanges in India. The important aspect of the

Takeover Code is that any acquirer of more than 5%, 10%, 14%, 54% or 74% of the shares or voting rights in a company has to disclose, at every stage, the aggregate of his or her shareholding or voting rights. The disclosure must be made to the company and to the stock exchanges where shares of the target company are listed. There are various other, continual disclosure obligations; for example, the acquirer also has to disclose to the company and the relevant stock exchanges any purchase aggregating two percent or more of the share capital of the target company within two days of such purchase and must also disclose what his or her aggregate shareholding will be after the acquisition. A failure to make such disclosure will incur a penalty of Rs. 250 million or three times the amount of profits resulting from such failure, whichever is greater.

Before acquiring shares or voting rights that (together with the shares or voting rights held by persons acting in concert with the acquirer) would entitle the acquirer to exercise 15% or more of the voting rights of a company, the acquirer must make a public announcement that he or she will acquire, at a minimum, an additional 20% of the equity shares of the company.

### III. Reforms Recommended by the "Irani Report"

The Irani Report<sup>16</sup> has observed that the process of mergers and acquisitions in India is a court-driven, long and drawn-out process that is problematic. A listed company undertaking a restructuring must undergo a tiered procedure that involves dealing with the stock exchange, the high court, the company's shareholders and creditors, the registrar of companies, and the regional director. This entire process can take anywhere from six to eight months and has, in some cases, taken more than a year. The Companies Act contains provisions relating to mergers and acquisitions and the related issues of compromises, arrangements and restructurings. Other provisions of the Companies Act, however, are also implicated in each case of a merger or acquisition; thus, the procedure remains far from simple.

In this context, the Irani Report made the following key recommendations pertaining to mergers and acquisitions:

- (1) A single forum for approving schemes of mergers should be established in which, over a period of one or two days, all the interested stakeholders (including regulators) could meet and decide on the transaction.
- (2) Valuation should be carried out by independent registered evaluators, rather than by court-appointed ones.



- (3) A uniform nationwide, reasonably priced stamp-duty regime should replace the prevailing system of each state having its own separate and differing stamp duty.
- (4) The law should provide an exit opportunity for the public shareholders in the case of the merger of a listed company into an unlisted company, and vice versa, or in the case when substantial assets are moved out of a listed company in a de-merger. In other words, a de-listing mechanism should be available when either (A) the restructuring results in the public shareholding falling below 10% or (B) 90% of the public shareholders opt for the exit route.
- (5) Only shareholders and creditors having a significant stake, at a level to be prescribed by law, should have the right to object to any scheme of merger.
- (6) Indian law still does not allow for an Indian company to merge into a foreign company. Cross-border mergers and acquisitions should be recognized, and Indian shareholders should be permitted to receive foreign securities or securities in lieu of Indian shares (especially in listed companies), so that they become members of the foreign company or holders of a security with a trading right in India.
- (7) A company should be allowed to be dissolved without winding up with court intervention. International practices and a coordinated approach should be adopted in amending the provisions regarding merger in the Companies Act.
- (8) Because the shareholders need to have complete information in the case of a scheme of merger or an acquisition, especially in the case of seller-initiated mergers, the Companies Act and rules thereunder should set out the disclosure requirements to be included in the explanatory statements sent to the shareholders in connection with the scheme filed with the court or other tribunal.
- (9) In the case of companies required to appoint independent directors, the Companies Act should mandate that a committee of independent directors serve as a monitoring body to ensure the adequacy of disclosures.
- (10) A separate electronic registry should be established for filing schemes under Sections 391-394 of the Companies Act. Filing with such an

electronic registry would replace filing with local registration offices where the properties of the company are located.

#### IV. Mode of Acquisition

An acquisition may take the form of a stock acquisition, an asset acquisition, or the acquisition of control. Generally, an acquisition involves the acquisition of the business of a company. It is for the acquirer to identify whether such acquisition should be an acquisition of stock or of assets. The determination is generally based on the status of the target company vis-à-vis its liabilities. In an asset acquisition, the acquirer chooses to acquire all assets of the target company without any liabilities; in a share acquisition, on the other hand, the acquirer acquires the ownership of the target company and has the benefit of its assets as well as the burden of its liabilities. In many cases, it is the acquirer's due-diligence review of the target company that enables the acquirer to decide whether to acquire assets or shares. There are also instances of acquiring the business of a company as a going concern, whereby the assets, liabilities, and employees are acquired for a lump-sum consideration.

#### V. Transactional Issues

Finalizing an acquisition requires that various transactional issues be discussed, negotiated, finally agreed upon and properly reflected in the definitive purchase agreement. The representations and warranties of the company to be acquired and of the seller—especially the representation that full disclosure has been made to the acquirer—are an important part of that agreement from the acquirer's perspective, whether or not the transaction involves a cross-border Indian acquisition. The seller will seek to qualify its representations and warranties to reflect what has come to light in the due diligence exercise.

India being a country with a vast number of laws, it is necessary for a foreign acquirer to have the comfort of knowing to what extent the target company has been in compliance with those laws; moreover, the acquirer will want full disclosure of those matters as to which there has not been compliance. As for the issue of the post-closing survival of representations and warranties, it is typical for the parties to agree to a survival period of between three and four years. As for the issue of indemnity, the concepts of *de minimis* liability for which there is no recourse and of an overall cap on potential liability, as well as requiring a minimum threshold or basket amount before the seller can be held liable, are concepts that will likely be put forward by the seller to reduce its exposure to a certain extent. In the negotiation of such liability limits, it is essential for the acquirer (who, of course, will seek a blanket indemnity with-

out any limits or caps) to keep in mind the local laws of the relevant country and the type and value of the claims that may arise.

Conditions precedent to closing are essential in addressing and ensuring that all approvals and consents have been obtained to allow the transaction to be consummated. Moreover, conditions precedent to closing that involve curing any problems that were discovered during the due-diligence review help ensure that the acquirer will not also acquire those problems at closing.

An acquisition can also be limited to the acquisition of a majority or minority stake in the target business. In a transaction involving the acquisition of a minority stake, the acquirer would seek certain rights in relation to the management of the company. Such rights would be in the nature of having representation on the board and having veto rights regarding certain matters relating to the operations of the company. Other rights that would be of concern to an acquirer of a minority stake include a guaranteed return on investment, having a preference upon liquidation and the distribution of dividends, anti-ratchet and anti-dilution provisions, exit options, and non-compete and non-solicitation covenants. Also sometimes sought are restrictions on transfers of shares, such restrictions taking the form of a right of first refusal, a right of first offer, tag-along rights, drag-along rights, and put or call options, for example.

It should be noted that all corporate matters and rights extended to the parties to a transaction need to be adequately reflected in the articles of association (i.e., the bylaws of an Indian company), so as to be enforceable against the Indian company. However, since an Indian public company cannot restrict the transfer of its shares, shareholders, in addition to a shareholders' agreement, also enter into a nondisposal agreement, in which they agree to transfer their shares only in the manner provided therein.

An important element of merger and acquisitions involving a foreign company and an Indian company is the status of the Indian company, that is, whether it is a private limited company or a public limited company. A private limited company is more able to provide for restrictions, and the investment involving such a company can be structured in a more suitable manner since a private limited company is not restricted to having only two classes of shares (i.e., equity and preference), as is the case for a public company. There have been cases in which an acquirer has identified a target company that is a public company, but, for the purpose of the acquisition, has structured the transaction so as to

convert the target company into a private limited company before proceeding with the acquisition.

In short, mergers and acquisitions come in various forms, and investors need to understand what best suits their needs.

## Endnotes

1. No. 1 of 1956, as amended.
2. An "arrangement" includes a reorganization of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both those methods.
3. "Members" include every person holding share capital of a company and whose name is entered as beneficial owner of record.
4. High courts are state courts; there are currently twenty high courts at: (i) Allahabad, (ii) Hyderabad, (iii) Mumbai (Bombay), (iv) Calcutta, (v) Delhi, (vi) Guwahati, (vii) Ahmedabad, (viii) Shimla, (ix) Srinagar, Jammu, (x) Bangalore, (xi) Ernakulam, (xii) Jabalpur, (xiii) Chennai (Madras), (xiv) Cuttack, (xv) Patna, (xvi) Chandigarh, (xvii) Jaipur, (xviii) Gangtok, (xix) Ranchi, and (xx) Nainital.
5. 1 Company L.J. 307 (2005).
6. Section 394(4) of the Companies Act specifically states that the transferee company shall be a company as defined under the Companies Act and the transferor company can be a body corporate, which includes a foreign company.
7. No. 54 of 1969, as amended.
8. No. 12 of 2003.
9. No. 43 of 1961, as amended.
10. The term "assessment" here would include the computation of income.
11. The amalgamating company must have held three-fourths of the book value of fixed assets for a period of two years prior to the amalgamation and must have been engaged, for three years prior to the amalgamation, in the business that is being absorbed. See IT Act § 72(A).
12. No. 2 of 1899, as amended.
13. The regulations were framed pursuant to Section 47 of the Foreign Exchange Management Act, 1999, No. 42 of 1999.
14. As a governmental report has observed, India permits FDI in nearly all activities under automatic route except for ownership restrictions in certain industries on strategic and security grounds. See "A Comprehensive Manual for Foreign Direct Investment-Policy & Procedures" issued by Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Government of India, available at [www.dipp.nic.in/manual/manual\\_11\\_05.pdf](http://www.dipp.nic.in/manual/manual_11_05.pdf).
15. These regulations were issued pursuant to the Securities and Exchange Board of India Act, 1992, No. 15 of 1992.
16. The report dated 31 May 2005 of the Expert Committee advising the Indian Government on the new Company Law, which committee was chaired by Dr. Jamshed J. Irani and set up by the Ministry of Company Affairs by order dated 2 December 2004.

**Vineet Aneja is a partner in the New Delhi office of Fox Mandal & Co. in India.**

# Public-Private Partnerships in Brazil: Opportunities and Risks for Investors

By Andrew J. Dell'Olio

## I. Overview and Goals

“Public-private partnerships”<sup>1</sup> (PPPs) in Brazil were authorized by a law signed by Brazilian President Luiz Inácio Lula da Silva on 30 December 2004 that took immediate effect (the “PPP Law”). This statute applies to all federal, state and local government agencies, special funds, public foundations and state-owned or partially state-owned companies.<sup>2</sup> The goal of the PPP program is to encourage private investment in public infrastructure, principally transportation facilities critical to Brazilian exports, such as railways, roads, and ports. Social service facilities, such as hospitals, clinics, schools and prisons, are also encompassed by the program, although they are of lesser priority. The statute established the following broad guidelines for the program:

- efficient implementation of governmental programs and use of public resources;
- respect for the rights of private firms contracted to provide services, as well as those of the end-users of the services;
- non-delegability of the government’s regulatory powers;
- fiscal responsibility;
- transparency in decision-making procedures;
- fair allocation of risk between the parties; and
- financial sustainability of specific projects.<sup>3</sup>

The statute is intended to avoid some of the downsides of traditional concession arrangements. In the past, a private concessionaire constructed and/or operated a public facility and was compensated by either of two methods: (i) fixed government payments or (ii) all or a percentage of the concession’s revenues collected from end-users.<sup>4</sup> Rarely was there a combination of both payment methods. The basic problem with such arrangements was that one party assumed the entire financial risk. In instances where the public sector paid the entire bill, limited budgets often prevented necessary investments. On the other hand, private investors were often unwilling to assume the financial risks inherent in relying exclusively on user tariffs for a return on their investments. The PPP model reduces the risk of both methods by combining them, at least in the case of “sponsored” concessions (see Part II *infra*). Neither the public nor the private sector need assume the full cost and risk of the project. If, for example, half the

project’s costs are covered by guaranteed, fixed government payments, the investor’s overall investment risk is reduced, and a greater portion of user tariffs may be counted as profits. The guaranteed payments attract private investment, enabling the public sector to undertake projects it could otherwise not afford.

Of course, the objective risk of the project is not reduced; it is simply *apportioned* between the public and private sectors, thereby effectively reducing their respective shares of that risk.

## II. Applicability and Limitations

The PPP Law applies to, and distinguishes between, two types of concessions: “sponsored” and “administrative.” “Sponsored” concessions involve a private concession to construct public works and/or provide public services, in which the concessionaire will receive a portion of revenues from user tariffs in addition to receiving guaranteed payments from the government.<sup>5</sup> For example, in a concession for the construction and/or administration of a roadway, the private concessionaire will receive a percentage of toll revenues, as well as fixed payments from the government to supplement those revenues. Should revenues fall short of expectations, the private concessionaire will at least be able to count on fixed payments to recoup part of its investment. Government payments in these “sponsored” concessions cannot exceed 70% of the total remuneration to the private concessionaire, unless a higher percentage is expressly authorized by law for a specific project.

In contrast, an “administrative” concession is one in which the private concessionaire provides services to the government and receives only fixed government payments, even if that concession incidentally involves constructing a public facility.<sup>6</sup> For example, in a concession for the construction and/or management of a prison facility or a low-income health clinic, the private concessionaire cannot rely on a sufficient revenue stream from inmates or indigent patients, and will depend entirely on government payments.

Both “sponsored” and “administrative” concessions are also regulated by Law 8987 of 13 February 1995, the General Concessions Law. The PPP Law does not apply to “ordinary” concessions, or those in which the government makes no payments to the private concessionaire, meaning that the private concessionaire’s only



source of income is the revenue stream from the end-users of the services or facility.<sup>7</sup> These “ordinary” concessions continue to be regulated by the General Concessions Law.<sup>8</sup>

In this sense, the “sponsored” concession is the more innovative form of concession, since the project’s risk is apportioned between the public and private sectors, and the payments to the private concessionaire are apportioned between the government and end-users. On the other hand, both “administrative” and “ordinary” concessions follow the two traditional methods of compensation described above (i.e., fixed payments or revenue sharing). The fixed payments from the government in “administrative” concessions may, of course, be made on a periodic or lump-sum basis, either throughout or at the end of the concession’s term, respectively.

The aggregate value of government payments made on all PPP contracts cannot exceed one percent of net tax revenues per fiscal year. More specifically, the federal government cannot even enter into a new PPP contract if the aggregate value of its payments on PPP contracts signed in the previous fiscal year exceeds one percent of the current fiscal year’s net revenues or if the required annual payments over the next ten fiscal years exceed one percent of the projected net revenues for those respective years.<sup>9</sup> A PPP contract must have a minimum value of 20,000,000 Brazilian Reais and a term of between five and thirty-five years, including all extensions of the term (see Part VI.C. *infra*).<sup>10</sup>

### III. The Partnerships’ Structure: the Special Purpose Vehicle (SPV)

In the past, the arrangement between the public and private sectors was a purely arm’s length contractual relationship. Under the PPP regime, the private concessionaire and the government are *partners*, potentially co-shareholders of a legal entity that will manage a facility in addition to constructing, modernizing or expanding it, as the case may be.<sup>11</sup> Prior to the signing of any contract, a “special purpose vehicle” (SPV) must be created to manage and implement the project. The SPV may take the form of a publicly traded company (*Sociedade Anônima* in Brazil) and must comply with all regulations relating to corporate governance and accounting standards.<sup>12</sup> Under normal circumstances, the private concessionaire will hold the majority of the SPV’s voting capital.<sup>13</sup> There are, however, two situations in which either a lender or the government may “step in” and take control of the SPV. Both involve the private concessionaire’s default.

The first situation is the private concessionaire’s default on a loan agreement (with either a private financial institution or one controlled by the Brazilian government), in which case the lender may “step in”

and acquire majority control.<sup>14</sup> This right, granted to a lender, is a classic “step-in” right, since it is enforceable upon the private concessionaire’s default. Article 5, § 2 of the PPP Law permits the inclusion of a contractual clause that will specify the conditions under which the government can *authorize* a transfer of a majority stake in the SPV to a lender when the private concessionaire encounters financial or performance problems. This type of clause will be included to allow for a rescheduling of the SPV’s debts or to ensure the performance of the contract. The lender will, in any event, most likely have a provision in the loan agreement that governs its “step-in” rights. The PPP statute merely grants the government some control over the circumstances in which the lender can exercise its rights vis-à-vis the private borrower.

A second situation is one in which the government intervenes in the concession and assumes control of the SPV in order to assure the adequacy of the public services, as is also authorized by the General Concessions Law. By way of example, this may occur when the private concessionaire defaults on a loan and/or mismanages the project to the extent that it affects its profitability or liquidity.<sup>15</sup>

The private concessionaire’s controlling interest in the SPV is not freely alienable. The private concessionaire cannot sell a majority stake (presumably to an unrelated private third party) without the express authorization of the government.<sup>16</sup> Understandably, the government desires to retain at least some control over who is ultimately responsible for the project. Both the pre-bid documents and the contract may govern the conditions under which a controlling interest may be transferred, outside the default and “step-in” provisions.<sup>17</sup>

Although the SPV will technically be the *owner* of the facilities during the term of the concession, title to the facilities will revert to the government at the conclusion of the concession (which can be no longer than 35 years).

No more than 70% of the SPV’s “funding sources” (*fontes de recursos financeiros*) can come from the public sector.<sup>18</sup> Funding sources are defined as loans and capital contributions to the SPV.<sup>19</sup> If private pension funds and/or state-owned companies are included among the funding sources, this limit is raised to 80%.<sup>20</sup> Both the 70% and 80% limits can be raised to 80% and 90%, respectively, when the project takes place in underdeveloped regions of Brazil not normally attractive to private investors.<sup>21</sup>

The Brazilian National Monetary Council will issue comprehensive guidelines for private lending to PPP projects, from both banks and private pension funds.<sup>22</sup>

The Secretariat of the Brazilian National Treasury will issue guidelines for the consolidation of public accounts spent on PPP projects, for the purpose of compliance with the one-percent budgetary limits (see Part II *supra*).<sup>23</sup>

#### **IV. The Regulatory Framework: The PPP Management Committee (CGP)**

The PPP Law delegated the drafting of detailed regulations governing the program to the PPP Management Committee (*Comitê Gestor de Parceria Público-Privada* or CGP). Created by presidential decree on 4 March 2005 (the “CGP Decree”), the CGP will be comprised of one representative each (a permanent representative and his or her alternate) from the Ministry of Planning, the Ministry of Finance, and the President’s Chief of Staff.<sup>24</sup> The representative of the Ministry of Planning will serve as the Chair.<sup>25</sup> The CGP will meet at least once per month, or as frequently as meetings are called by the Chair. A representative from the ministry or agency sponsoring a project (hereinafter referred to as the “sponsoring ministry”) must be present and must participate in any meeting at which the CGP will analyze that project.<sup>26</sup> The CGP Decree does not specify whether these non-member participants have a vote at these meetings. The Chair may also request that representatives from another government ministry or agency, or of the private sector, participate in the meeting although these participants will have no vote.<sup>27</sup> The CGP can also create temporary special commissions, for the purpose of evaluating specific projects, and can request that government or private-sector personnel participate in these commissions as well.<sup>28</sup>

The CGP will promulgate its own internal regulations and issue its decisions in the form of resolutions. When circumstances warrant, the Chair may analyze issues independently of other CGP members, but must present such issues to the full CGP at the next scheduled meeting.<sup>29</sup> Sponsoring ministries wishing to undertake projects must submit their requests to the CGP for its approval. These requests must be accompanied by (i) a report from the Ministry of Planning attesting to the project’s merit, and (ii) a report from the Finance Ministry confirming that the project’s costs will not exceed the one-percent budgetary limits.<sup>30</sup> Although the sponsoring ministry will draft the pre-bid documents and the contract to be signed, the CGP will verify that these documents comply with the requirements of the PPP statute and with any further requirements that the CGP may issue in the future.<sup>31</sup> Unanimity of the CGP’s voting members is required for the opening of a bidding process, the approval of pre-bid documents (*Editais*), and the signing of all contracts.<sup>32</sup>

Every six months, the CGP will report to the various sponsoring ministries regarding the progress of active PPP projects administered by them or falling

within their respective areas of regulatory jurisdiction.<sup>33</sup> The CGP will file similar progress reports annually with the Brazilian Congress and with the Brazilian Federal Court of Claims.<sup>34</sup> If necessary to prepare these reports, the CGP has the authority to requisition documentation regarding the performance of PPP contracts from the private parties or sponsoring ministries that are signatories thereto.<sup>35</sup> The CGP must also approve the overall PPP Plan and define priority sectors for PPP projects.<sup>36</sup> As mentioned above in Part I, the immediate focus will be transportation infrastructure critical to exports (ports, railroads, etc.).

The CGP’s two administrative arms will be the Technical Commission and the Executive Secretariat. The Technical Commission will do the CGP’s “real work” of defining priority sectors and studying PPP projects in detail. It will issue detailed recommendations as to pre-bid procedures and as to criteria for the approval of *Editais* and contracts.<sup>37</sup> Similar to the plenary CGP, the Technical Commission will have representatives from the Ministries of Planning and Finance, and the President’s Chief of Staff, although there will be two representatives (two permanent and two alternate) from each. Also serving on the Technical Commission will be one representative each (a permanent and an alternate) from the Ministries of Development, Industry and Foreign Trade, Transportation, Mines and Energy, National Integration, and the Environment, as well as a representative from the BNDES, the Banco do Brasil and the Caixa Econômica Federal.<sup>38</sup> As with the plenary CGP, the Technical Commission will be chaired by its representative from the Ministry of Planning.<sup>39</sup> It may also solicit the input of other government agencies or the private sector to assist in analyzing projects.<sup>40</sup> A sponsoring ministry, if not one of these standing members of the Technical Commission, must also be represented in meetings analyzing contracts administered by that sponsoring ministry.<sup>41</sup> The CGP Decree leaves unclear the voting powers of these additional participants.

A bureau of the Ministry of Planning, called the Economic Council (*Assessoria Econômica*), will serve as the CGP’s Executive Secretariat. The Executive Secretariat will fulfill basic administrative and clerical functions such as scheduling meetings of the CGP and the Technical Commission and drafting their reports on the performance of contracts.<sup>42</sup> Most importantly, the Executive Secretariat serves as the liaison between the Technical Commission and the sponsoring ministries submitting their proposed projects for the Commission’s consideration. The Executive Secretariat also monitors parties’ compliance with the CGP’s guidelines although it is the Technical Commission that establishes the form and content of the periodic reports on the progress of contracts.<sup>43</sup>

The CGP also regulates the crossover between PPPs and the Brazilian privatization program. If a PPP project is needed in addition to or in support of a privatized service or asset, the ministry or agency overseeing that specific privatization is authorized to submit the project to the CGP.<sup>44</sup> If approved, the project will be governed by both the PPP legislation and the regulations of the privatization program.<sup>45</sup>

## V. The PPP Guarantee Fund (FGP)

To ensure government payments under PPP contracts, a guarantee fund (*Fundo Garantidor de Parcerias Público-Privadas* or FGP) has been created. The federal government, either directly or through independent agencies or public foundations, is authorized to contribute up to 6 billion Reais to the fund.<sup>46</sup> The FGP's assets are dedicated specifically to the PPP program, and cannot be used for general public spending. Although the FGP is technically a "private" entity, the PPP Law mandated that it be managed by a financial institution controlled by the Brazilian federal government, which will also have the authority to represent it in legal proceedings.<sup>47</sup> The government has selected Banco do Brasil to manage the FGP.<sup>48</sup> To fulfill this role, Banco do Brasil has created a subsidiary, *Banco do Brasil Distribuidora de Títulos e Valores Mobiliários* (BBDTVM).<sup>49</sup> As per the PPP Law, BBDTVM will now be responsible for the profitability and liquidity of the FGP's assets.<sup>50</sup>

Like any private company, the by-laws and internal regulations of the FGP will be approved at shareholders' meetings.<sup>51</sup> Capital contributions to the FGP may be made in the form of cash, government bonds, real property or personal property, including the shares of government-owned companies.<sup>52</sup> As of September 2005, the FGP's capital contributions consist of shares of fifteen blue-chip Brazilian companies, among which are Embraer, Petrobrás, Usiminas, Banco do Brasil and Companhia Vale do Rio Doce.<sup>53</sup> The FGP's guarantees are issued proportionally to each shareholder's respective shareholding percentage, and shareholders' liability for the FGP's aggregate guarantee obligations is limited to the amount of their capital contributions.<sup>54</sup> The FGP will not pay profits to its shareholders, but guarantees them the right to withdraw their entire shareholding investment, up to the limits of the amounts not already encumbered to honor guarantees.<sup>55</sup> The shareholders, by vote at a meeting, may dissolve the FGP, but only when all of the fund's guarantee obligations have either been paid to, or waived by, PPP creditors.<sup>56</sup> The FGP's assets, if any remain, will then be distributed to shareholders proportionally to their shareholding interests as of the date of dissolution.<sup>57</sup> Of course, the FGP may not issue guarantees that, in the aggregate, exceed its total available assets.<sup>58</sup> The FGP may set aside certain assets specifically earmarked for certain projects—known as

"waterfall accounts"—which cannot be encumbered to satisfy the fund's general obligations.<sup>59</sup> These earmarked assets, if real estate, must be registered in the local Real Estate Registry or, if assets other than real property, in the local *Cartório*.<sup>60</sup>

The FGP may issue the following types of guarantees:

- surety bonds;
- pledges of personal property or of an interest in the FGP's assets, although the beneficiary cannot take possession of such property until after an enforcement action;
- mortgages on real property owned by the FGP;
- placing assets in trust for the beneficiary, although, again, the beneficiary cannot take possession of such assets until after an enforcement action;
- other contracts that serve as guarantees, provided that they too do not transfer title or direct possession until after an enforcement action; and/or
- personal or secured guarantees, secured by specifically earmarked assets of the FGP.<sup>61</sup>

It is anticipated that surety bonds will be the most common guarantee issued by the FGP.<sup>62</sup>

Except as otherwise provided in the contract, the private concessionaire may bring an action to enforce the guarantee (i) 45 days after a payment is past due on a bill submitted to, and accepted by, the sponsoring ministry; or (ii) 90 days after a payment is past due on a bill submitted to, and not expressly rejected by, the sponsoring ministry.<sup>63</sup> The FGP must then make payment to the private concessionaire within fifteen days.<sup>64</sup> If the FGP itself does not honor its guarantee, the private concessionaire may encumber the FGP's own assets to satisfy the obligation.<sup>65</sup> Once the FGP has honored a guarantee and paid the private concessionaire, it will acquire subrogation rights against the sponsoring ministry.<sup>66</sup>

## VI. The PPP Process

### A. The *Edital* and Bidding Documents

Before a project is authorized to solicit bids, the sponsoring ministry must undertake a "technical study" of the pros and cons of using the PPP regime.<sup>67</sup> Essentially, in order to qualify for PPP status, the technical study must demonstrate that a PPP is the most efficient method for the undertaking and that it will comply with applicable fiscal and budgetary regulations.<sup>68</sup> This technical study is an internal one, conducted by the sponsoring ministry, separate and in addition to the certification of merit from the Planning Ministry and the budgetary green light a project receives from



the Finance Ministry, both of which are also prerequisites for CGP consideration (see Part IV supra).

Similar to a “request for proposals” (RFP) in United States public-sector procurement, the *Edital* in Brazilian law is the basic pre-bid document containing the terms and conditions of a concession or other government contract. The PPP Law leaves many details regarding the selection of bidders to the discretion of the sponsoring ministry. These details, as well as provisions related to optional contract clauses (see Part VI.D. infra), must be specified in the *Edital*. While the CGP sets the overall rules for the bidding process, the sponsoring ministry prepares the *Edital* and submits it for the CGP’s review and approval, as noted above in Part IV. The sponsoring ministry then conducts the bidding process, evaluates proposals and selects the private concessionaire. The sponsoring ministry, not the CGP, is the public-sector signatory to the contract and is accordingly responsible for making periodic payments and monitoring the private concessionaire’s performance during the contract’s term.<sup>69</sup> The sponsoring ministry must send to the CGP a semi-annual report on the progress of the contract and the project. This report, in turn, is incorporated into the CGP’s annual reports on all PPP contracts made to the Brazilian Congress and the Federal Court of Claims (see Part IV supra).<sup>70</sup>

Prior to the bidding process, a draft of the *Edital*, along with a preliminary draft of the contract to be signed, must be published (i) in an official government publication, (ii) in major daily newspapers and (iii) on government websites.<sup>71</sup> A period of at least thirty days for public comment will follow publication.<sup>72</sup> Seven days after the closure of the public-comment period, the final *Edital* may be published.<sup>73</sup> The draft *Edital* must identify the main points of the project, including term, estimated value and scope of work.<sup>74</sup> The final *Edital* will include a final draft of the contract for the review of prospective bidders.

## B. Evaluation Criteria

The sponsoring ministry may require prequalification of bidders as to their technical ability to perform the work and may evaluate proposals based on (i) price alone; or (ii) a combination of price and technical ability, according to a weighted scale of factors delineated in the *Edital*.<sup>75</sup> The *Edital* may permit bidders to amend their proposals or correct pro-forma errors therein, up to the submission deadline.<sup>76</sup> The *Edital* may also require the bidder(s) to post a bid bond and to submit disputes to arbitration or other means of alternate dispute resolution.<sup>77</sup>

## C. The Contract: Required Clauses

Although many details of the contracts are yet to be defined by the CGP’s regulations, the PPP Law itself specifies several clauses that are required in every PPP

contract. In addition to the contractual clauses mandatorily included in any concession agreement in Brazil, PPP agreements require clauses pertaining to the following:

- a term of between five and thirty-five years;
- penalties applicable to both parties for nonperformance and default;
- allocation of risks among the parties, including provisions as to acts of God, force majeure, acts of state, and extraordinary economic risks;
- the means of payment and of indexing (i.e., increasing) contract prices and tariffs to compensate for inflation;
- the means by which the levels of quality and modernity of the services will be maintained;
- the terms that define default by the government on its payments, the means and time frame for the cure of such default and the means by which the private concessionaire may enforce its rights;
- objective criteria for the evaluation of the private concessionaire’s performance;
- performance guarantees by the private concessionaire, proportional to the risks involved in the undertaking;
- a sharing with the government of the financial gains realized by the private concessionaire as a result of reduced credit risks; and
- a provision authorizing the government to inspect assets that will revert to its possession and ownership, and authorizing the government to withhold payments in the amount proportional to damages to such assets.<sup>78</sup>

## D. The Contract: Optional Clauses

The PPP Law permits, but does not require, the following provisions to be included in a contract:

- the terms under which the government may authorize the transfer of a controlling interest in the SPV to lenders (see Part III supra);
- creation of a budgetary payment reserve to cover the government’s payment obligations; and
- indemnification of the private concessionaire for the early termination of the contract.<sup>79</sup>

There are several means by which the government can effectuate its payments to the private partner:

- cash payments;
- an assignment of credits (other than tax credits);
- a grant of rights vis-à-vis the federal government;
- a grant of rights over government assets; and
- other means permitted by law.<sup>80</sup>

The contract itself may also include provisions guaranteeing the government's payments. These payment guarantees should not be confused with the guarantees provided by the FGP; they are made by the sponsoring ministry itself, as assurances of its obligation to compensate the private concessionaire. These guarantees can take the following forms:

- an assignment of the project's revenue stream directly to the private partner;
- establishment of "special funds," provided for by law, or use of existing special funds;
- payment bonds issued by private insurers;
- guarantees issued by international organizations or financial institutions not affiliated with or controlled by the government;
- guarantees issued by a guarantee fund or state-owned company created for this specific purpose; and
- other means permitted by law.<sup>81</sup>

The government may not prepay for any services called for in the contract but may make periodic progress payments, as certain services, or portions thereof, become available.<sup>82</sup> As an example, on a concession to operate a port facility for 30 years, the government may make monthly payments for services rendered each month. As another example, on a project to build or modernize ten piers at that port facility, the government cannot make any payments upon the signing of the contract and before work starts but may make periodic progress payments proportionate to the five piers completed midway through the contract. A private concessionaire can also earn extra, merit-based compensation, that is, the contract may provide for variable payments tied to performance.<sup>83</sup>

## VII. Prognosis

A major force behind the PPP legislation was former Planning Minister and BNDES President Guido Mantega. During his term as Planning Minister, he introduced the draft statute to the Brazilian Congress in November 2003 and was President Lula's principal lobbyist for its passage. Mr. Mantega became Finance Minister of Brazil in March 2006, and, in this role, will oversee enforcement of the budgetary limits of the PPP Law. Of the twenty-three projects on the government's "wish list" through 2007, five are now considered top priorities: (i) the North-South Railway; (ii) the São Paulo Railway Ring (*Ferroanel*); (iii) the rail connection to the Port of Paranaguá; (iv) the BR-116/BR-324 highway; and (v) the "ring road" around Rio de Janeiro.<sup>84</sup> Mantega believes that Brazil will have the advantage of learning from the experiences of other countries that have implemented similar PPP programs and will be able to avoid their mistakes. Examples of such mistakes are the 18-

month delay in commencing the first project in the United Kingdom after passage of British PPP legislation and the huge cost overruns that plagued Portugal's transportation projects.<sup>85</sup>

An obvious shortcoming of the PPP legislation is the relatively small financial commitment made to the FGP. Considering the scale of infrastructure projects needed throughout Brazil, a limit of six billion Reais seems insufficient. To date, only 4.2 billion Reais of that limit have been contributed to the FGP.<sup>86</sup> It is possible, however, that the success of early projects may attract additional, private capital to the FGP.

Finally, much of the Lula administration's economic development agenda remains stalled due to the continuing congressional investigation into the governing Workers' Party corruption scandal. Although the investigation had delayed, for several months, the regulation and capitalization of the FGP, the stage is now set for the implementation of much-needed improvements to Brazil's physical infrastructure. It has been anticipated that the *Editais* for the first several projects would be issued in early 2006.<sup>87</sup> As the projects progress, we will be able to observe and evaluate the effectiveness of Brazil's PPP legislation.

## Endnotes

1. These are known in Brazil as *Parcerias Público-Privadas*.
2. Law 11,079 of 30 Dec. 2004, art. 1, available at <http://www.sendado.gov.br> or at <http://www6.senado.gov.br/sicon/PreparaPesquisaLegislacao.action> (hyperlink: enter number of law—11.079—at "Numero" and the year—2004—at "Ano" and click on "Pesquisar" or "search"; then choose "texto integral" for full text of the law).
3. *Id.* art. 4.
4. Note that, under traditional concession arrangements, fixed government payments were due to a private concessionaire within thirty days after completion of construction services, when the services had been procured via competitive bidding.
5. Law 11,079 of 30 Dec. 2004, art. 2, § 1. A "sponsored" concession is referred to as a *concessão patrocinada*.
6. *Id.* art. 2, § 2. An "administrative" concession is referred to as a *concessão administrativa*.
7. *Id.* art. 2, § 3.
8. Law 8.986 of Feb. 13, 1995 available at <http://www.sendado.gov.br> or at <http://www6.senado.gov.br/sicon/PreparaPesquisaLegislacao.action> (hyperlink: enter number of law—"8.986"—at "Numero" and the year—1995—at "Ano" and click on "Pesquisar" or "search"; then choose "texto integral" for full text of the law).
9. Law 11,079 of 30 Dec. 2004, art. 22.
10. *Id.* art. 2, § 4; art. 5, head paragraph, subsection. I. In Brazilian statutes, the "head paragraph" is referred to as the "*caput*."
11. Although the government and the private concessionaire may potentially be co-shareholders in the legal entity, it is anticipated that the typical PPP project will be implemented by a legal entity wholly owned by the private concessionaire. Nonetheless, even when the government has no shareholding interest in the

- entity, the two parties are still viewed as “partners,” in that they share certain risks and rewards, and are working toward a common goal.
12. Law 11,079 of 30 Dec. 2004, art. 9, §§ 2-3.
  13. *Id.* art. 9, § 4.
  14. *Id.* art. 9, § 5. The Banco do Brasil, S.A., the Caixa Econômica Federal and the Banco Nacional de Desinvestimento Econômico e Social (BNDES) are examples of financial institutions controlled by the Brazilian federal government.
  15. *Id.* art. 5, § 2, subsection I.
  16. *Id.* art. 9, § 1. Although the PPP Law does not preclude the controlling interest in the SPV from being held by two or more private parties, it is anticipated that most PPP projects will have a single private investor. It is conceivable, however, that the government will hold 49% of the SPE and that two (or more) private investors will each hold 25.5% or some other percentage or combination thereof.
  17. *Id.*
  18. *Id.* art. 27, head paragraph.
  19. *Id.* art. 27, § 2.
  20. *Id.* art. 27, § 1. Partially state-owned companies (*Sociedades de Economia Mista*) include Petrobrás and Embraer, in which the Brazilian government holds either a majority of voting capital or a “Golden Share,” granting it veto power over certain matters.
  21. *Id.* Underdeveloped regions are defined as the Northern, Northeastern, and Central-Western regions, in which the Index of Human Development is lower than the national average.
  22. *Id.* art. 24.
  23. *Id.* art. 25.
  24. The full name of the Brazilian Ministry of Planning is the Ministry of Planning, Budget and Management (*Ministério de Planejamento, Orçamento e Gestão*). It is the equivalent of the White House Office of Management and Budget, but with an additional function of planning.
  25. Decree 5,385 of 4 Mar. 2005, art. 2, head paragraph, available at <http://www.sendado.gov.br> or at <http://www6.senado.gov.br/sicon/PreparaPesquisaLegislacao.action>.
  26. *Id.* art. 5, § 1.
  27. *Id.* art. 5, § 2.
  28. *Id.* art. 6.
  29. *Id.* art. 7.
  30. *Id.* art. 8, § 2.
  31. *Id.* art. 3, head paragraph, subsection III.
  32. *Id.* art. 8, head paragraph. *Editais* is the plural of *Edital*, which is the basic public-sector procurement document (see Part VI.A. *infra*).
  33. *Id.* art. 3, head paragraph, subsection IV.
  34. *Id.* art. 3, head paragraph, subsection V. The Brazilian Federal Court of Claims is referred to as the *Tribunal das Contas da União*.
  35. *Id.* art. 14, § 1.
  36. *Id.* art. 3, head paragraph, subsection. I. The PPP Plan is referred to as *Plano de Parcerias Público-Privadas*.
  37. *Id.* art. 11.
  38. *Id.* art. 10, head paragraph.
  39. *Id.* art. 10, § 3.
  40. *Id.* art. 10, § 4.
  41. *Id.* art. 10, § 5.
  42. *Id.* art. 12, head paragraph.
  43. *Id.* art. 12, head paragraph, subsections. IV-V; at art. 14, head paragraph.
  44. *Id.* art. 13, head paragraph. The National Privatization Council (*Conselho Nacional de Desestatização*) oversees the entire privatization program and grants to ministries and agencies oversight of specific privatization programs, consistent with their respective areas of expertise and jurisdiction.
  45. *Id.* art. 13, sole paragraph. In Brazilian statutes, the “sole paragraph” is referred to as the “*parágrafo único*,” which may not always be the sole paragraph of an Article.
  46. Law 11,079 of 30 Dec. 2004, art. 16.
  47. *Id.* art. 16, § 1; art. 17.
  48. *BB deve ser o gestor de fundo garantidor de PPPs*, O Estado de S. Paulo, 7 June 2005. The National Monetary Council passed a resolution on 6 June 2005, requiring that the governmental financial institution managing the FGP be authorized by the Brazilian CVM (Securities and Exchange Commission) to manage investment portfolios.
  49. Lu Aiko Otta, *Investidor terá mais garantias nas PPPs*, O Estado de S. Paulo, 26 August 2005.
  50. Law 11,079 of 30 Dec. 2004, art. 17, § 3.
  51. *Id.* art. 17, § 1.
  52. *Id.* art. 16, § 4.
  53. Renata Veríssimo, *Aprovado regulamento do Fundo Garatidor das PPPs*, O Estado de S. Paulo, 16 Sept. 2005.
  54. *Id.* art. 18, head paragraph; art. 16, § 5.
  55. *Id.* art. 19.
  56. *Id.* art. 20.
  57. *Id.*
  58. *Id.* art. 18, head paragraph.
  59. *Id.* art. 21, head paragraph. Referred to as “*Patrimônio de afetação*.”
  60. *Id.* art. 21, sole paragraph. In Brazil, a real estate registry (*Cartório de Registro Imobiliário*) is similar to the registry in a local county clerk’s office in the U.S. where deeds and encumbrances against real property are recorded. A *Cartório de Títulos e Documentos*, which has no equivalent in the U.S. legal system, is an official registry of private contracts and documents.
  61. *Id.* art. 18, § 1.
  62. Renata Veríssimo, *Aprovado regulamento do Fundo Garatidor das PPPs*, O Estado de S. Paulo, 16 Sept. 2005. The Assistant Secretary of the Brazilian National Treasury, Tarcício Godoy, has stated that surety bonds will be the most common type of guarantee issued by the FGP.
  63. Law 11,079 of 30 Dec. 2004, art. 18, §§ 4-5.
  64. Renata Veríssimo, *Aprovado egulamento do Fundo Garatidor das PPPs*, O Estado de S. Paulo, 16 Sept. 2005.
  65. Law 11,079 of 30 Dec. 2004, art. 18, § 7.
  66. *Id.* art. 18, § 6.
  67. *Id.* art. 10, head paragraph, subsection I.
  68. *Id.*
  69. *Id.* art. 15.
  70. *Id.*
  71. *Id.* The *Diário da União*, a main daily official publication of the Brazilian federal government, is the approximate equivalent of the *Federal Register* in the U.S.



72. *Id.* art. 10, sub. VI.
73. *Id.*
74. *Id.*
75. *Id.* art. 12, head paragraph, subsections I-II.
76. *Id.* art. 12, head paragraph, subsection IV.
77. *Id.* art. 11, head paragraph, subsections I and III.
78. *Id.* art. 5, head paragraph. As per the General Concessions Law, all concession contracts in Brazil must include clauses addressing the following topics:
- the object, relevant geographic area and term of the concession;
  - the means and conditions of provision of services;
  - the criteria and parameters for defining the quality of services;
  - pricing and the means by which prices may be adjusted;
  - the rights, obligations and guarantees of both parties, including such provisions as they relate to the foreseeable need to change or expand services and to any related modernization, improvement or enlargement of facilities;
  - the rights and obligations of end-users of services;
  - the government agencies authorized to inspect the facilities and equipment, and to regulate the provision of services, as well as the terms under which they may do so;
  - administrative and contractual penalties to which the concessionaire is subject;
  - the circumstances for terminating a concession;
  - which assets, used by the concessionaire in its performance, revert to government possession and title;
  - indemnification provisions;
  - the circumstances under which the term may be extended;
- the necessity, form and frequency for submission of invoices by the concessionaire to the sponsoring ministry;
  - the requirement that the concessionaire make its periodic financial statements available; and
  - choice of forum and means of alternative dispute resolution.
79. *Id.* art. 5, § 2.
80. *Id.* art. 6. An example of a non-tax credit is the assignment of rental income on government-owned real estate leased to a private party.
81. *Id.* art. 8.
82. *Id.* art. 7.
83. *Id.* art. 6, sole paragraph.
84. Renée Pereira, *Investidor já espera editais das PPPs*. O Estado de S. Paulo, 16 Sept. 2005.
85. Nicola Pamplona, *PPP terá licitações em seis meses*. O Estado de S. Paulo, 24 Dec. 2004.
86. Renata Veríssimo, *Aprovado regulamento do Fundo Garatidor das PPPs*, O Estado de S Paulo, 16 Sept. 2005.
87. *Id.* Arno Meyer, a Planning Ministry official, forecasts that this will happen in 2006.

**Andrew J. Dell’Olio is an attorney with the New York City Housing Authority and was foreign counsel to the São Paulo law firm of Araújo e Policastro Advogados from 1998-2000. The author gratefully acknowledges the assistance of José Virgílio Lopes Enei, a partner at the São Paulo law firm of Machado, Meyer, Sendaz e Opice Advogados, in the preparation of this article.**

## ▶ Prefer the ease of e-mail?

**Start receiving NYSBA announcements via e-mail today!**

Provide us with your e-mail address\* to get timely information—and help save NYSBA money in mailing costs.

### ③ easy ways to update your member record:

- **Call** 1-800-582-2452
- **E-mail** [mis@nysba.org](mailto:mis@nysba.org)
- **Login** to [www.nysba.org](http://www.nysba.org), go to your myNYSBA page and edit your member profile (if you have questions about how to login, visit our website at [www.nysba.org/pwhelp](http://www.nysba.org/pwhelp)).

\*Member information is confidential and is only used for official Association purposes. NYSBA does not sell member information to vendors.



# Electronic Commerce and the New UNCITRAL Draft Convention

By Anjanette H. Raymond

## I. Introduction

On 23 November 2005, the United Nations General Assembly adopted a new draft convention on the use of electronic communications in international contracting, known as the Draft Convention on the Use of Electronic Communications in International Contracts.<sup>1</sup> The Draft Convention, in a similar manner as the 1996 UNCITRAL Model Law on Electronic Commerce, is intended to remove obstacles to the use of electronic communications in international contracting. However, the Draft Convention does contain new provisions and makes adjustments based on the lessons of prior legislative texts. As such, a review of the Draft Convention is an important consideration before widespread use occurs.

This article seeks to (1) review the Draft Convention on the Use of Electronic Communications in International Contracts, (2) draw distinctions between the Draft Convention and the Model Law, and (3) discuss current areas of ongoing concern.

## II. The Originations of the Draft Convention

### A. Overview

In response to the growing use of electronic commerce, the United Nations approved recommendations of the Working Group on Electronic Commerce<sup>2</sup> to prepare an instrument to address the needs of contracting in an electronic environment. During the early surveys and discussions, the working group determined that one of the main barriers to electronic contracting was the lack of legislation on a domestic level. Hence, the Working Group created two separate Model Laws: one that facilitates the recognition of electronic signatures<sup>3</sup> and one that facilitates electronic commerce.<sup>4</sup> Both of these Model Laws have facilitated—either through influence, adoption or both—the recognition of electronic contracting on the domestic front. However, the Model Laws could not remedy the issue of cross-border or international electronic contracting. Thus, the need for a Convention in the area was necessary to remove the barriers that continued to exist.

The Draft Convention is designed to complement the Model Laws, or other already existing domestic law, in the area of electronic contracting. As such, the Draft Convention adopts a media-neutral approach, which eliminates definitions and concepts based on a particular medium of electronic communication or technology. This approach is advantageous to domestic systems because it will allow (1) for adoption of the Convention

without widespread domestic law revisions, and (2) for continued technological advancement without the need to constantly update the Convention after adoption.

The Draft Convention is “aimed at enhancing legal certainty and commercial predictability where electronic communications are used in relation to international contracts.”<sup>5</sup> As such, the Draft Convention incorporates many or most of the Model Law provisions, such as those relating to (a) establishing the functional equivalence between electronic communications and paper documents, and (b) setting up a mechanism of attribution. However, the Draft Convention also includes new or updated provisions, including provisions relating to the following: (x) determining a party’s location in an electronic environment; (y) establishing the time of receipt of electronic communications; and (z) the use of automated message systems for contract formation. The implications of these provisions will be addressed below.

### B. Scope of Application

The Draft Convention has an expansive application as it applies to any type of electronic communication in the form of a data message used in the formation or performance of a contract, provided the parties communicating electronically have their places of business in different states.<sup>6</sup> Moreover, the application of the Draft Convention is not limited to parties whose places of business are in contracting states.<sup>7</sup> Parties may elect for the application of the Draft Convention without the need for every party to be from a contracting state.<sup>8</sup> In addition, the Draft Convention may be applicable in situations where choice-of-law rules lead to the application of the substantive law of a contracting state regardless of whether either party has a place of business in that contracting state.<sup>9</sup> Thus, the application of the Draft Convention is not dependent on either party’s having a place of business or residence in a contracting state.

In situations where there has been no specific election of application, there are two definitional issues to be resolved in the area of application: (1) electronic communication and (2) place of business.

Under the Draft Convention, “electronic communication”<sup>10</sup> is defined in general terms with reference to other definitions found in the Draft Convention (e.g., “communication” in Article 4(a)<sup>11</sup> and “data message” in Article 4(c)<sup>12</sup>). Not surprisingly, the drafters intended

for the scope of the Draft Convention to be as wide as possible, but limited to the area of “electronic” contracting.<sup>13</sup> As such, the wide, general definition should be read as expansive within the area of electronic contracting and should not be read to exclude any particular medium. Thus, at the current time—and hopefully in the future—the definition should encompass all types of “data messages.”

Unlike the relative simplicity of the general definitions, the Draft Convention also has to consider a manner of establishing—or working around—one of the most widely debated areas in electronic contracting: determining the location of the party and the implications that flow from that determination. To address this issue, the drafters operated from the presumption that parties have a duty to disclose their location.<sup>14</sup> With this in mind, the drafters crafted a provision setting forth the consequences of a failure to disclose location, as opposed to one creating a duty to disclose. Under the Draft Convention, when the contract does not identify a party’s location and if a party otherwise has no knowledge of the other party’s location, the fact that the parties have their places of business in different states is to be disregarded.<sup>15</sup> Moreover, contracting or performance occurring through the use of electronic communications that fails to appropriately identify an address for a business, be it a non-transitory virtual or a physical address, will result in the application of the default rule defining location.<sup>16</sup>

In addition, the drafters had to create a provision that would not establish a presumption of location based upon the technology used in the communications. Thus, under the Draft Convention, a party’s “place of business” is defined as the “place where the party maintains a non-transitory establishment to pursue an economic activity.”<sup>17</sup> In light of this definition, a party’s temporary locations—for example the location of the warehousing of virtual goods on a server<sup>18</sup>—would not allow the server’s virtual location to qualify as a place of business. In addition, a party’s place of business cannot be established based on the use of a domain name or an e-mail address that is connected to a specific country.<sup>19</sup>

### C. Declarations

As is standard with most conventions, the Draft Convention contains a series of declarations that a state can make with respect to particular provisions of the Draft Convention, such as the scope of application.<sup>20</sup> Interestingly, the Draft Convention allows for declarations to be made at any time, not just at the time of the deposit of its instrument of ratification, acceptance, approval or accession.<sup>21</sup> The drafters believed this to be an important allowance as the Draft Convention covers a rapidly advancing area of law.<sup>22</sup> Consequently, the

ability to make declarations, after deposit of its instrument, would allow a contracting state to remain confident in the flexibility of the Draft Convention.

### D. Interplay with Other Conventions

The Draft Convention had as one of its central purposes the harmonization of already existing international legal texts. Consequently, the Draft Convention needed to address the lack of provision for electronic media in many, if not all, of the already existing conventions. In this area, to date, there have been two interesting developments. First, one of the early studies of UNCITRAL determined that the Draft Convention was almost unnecessary in relation to the U.N. Convention on Contracts for the International Sale of Goods (CISG)<sup>23</sup> since the provisions of the latter already envision a flexible structure of contract formation, making formation through electronic contracting possible.<sup>24</sup> Second, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (commonly referred to as the “New York Convention”),<sup>25</sup> a convention not immediately springing to mind as being impacted by the Draft Convention, was taken into account by the drafters of the Draft Convention. The interaction of the New York Convention and the Draft Convention is important in two ways. First, the New York Convention’s use of the term “arbitration agreement,” as opposed to “arbitration contract,” required the Draft Convention to maintain the dual terminology of the terms “agreement” and “contract,” so as to enable applicability of the Draft Convention to matters covered by the New York Convention.<sup>26</sup>

Second, the New York Convention uses the term “original” in relation to arbitration agreements and awards;<sup>27</sup> however, this term is now widely used in electronic contracting to a different end. Consequently, Article 9 of the Draft Convention was amended to include provisions relating to the “original form” of a communication or contract. For example, Article 9(4) of the Draft Convention specifies that legal requirements pertaining to an “original form” are satisfied if “there exists a reliable assurance as to the integrity of the information [the electronic communication] contains from the time when it was first generated in its final form. . . .” Integrity is determined based upon the determination of whether the “information has remained complete and unaltered,” allowing, of course, for “any change which arises in the normal course of communication, storage and display.”<sup>28</sup> Neither of these definitions stands in conflict with the general understanding of the term “original” used in the New York Convention. Therefore, no conflict exists between the two terms. In addition, these concepts have gained acceptance beyond the definitions relating to arbitration. In fact, the same language exists in the UNCITRAL



TRAL Model Law on Electronic Commerce, which has been widely received as sufficient in most circumstances. Consequently, these provisions, originally designed to cover only arbitration agreements, have been found useful in regard to the overall Draft Convention and thus are no longer limited to arbitration agreements.<sup>29</sup>

### III. Well-Debated Issues

#### A. Overview

There were several issues that caused great debate within the working group, such as automated contracting and determining the time of receipt, which were eventually addressed within the text of the Draft Convention. However, some issues, such as false or inaccurate representations were never addressed within the text of the Draft Convention. This has led some authorities to wonder what will occur in the areas excluded from coverage under the Draft Convention. Probably one of the most contentious issues left unaddressed is in the area of false representations made by a party during the contracting process. These omissions, however, should not cause difficulties in adoption of the Draft Convention, since the underlying issues were never considered within the purview of the drafters.<sup>30</sup> In fact, the Draft Convention is designed to stand on the shoulders of existing domestic law;<sup>31</sup> this is the only way that a convention such as this could receive widespread adoption in light of the variances that exist between the legal systems of various jurisdictions (including areas that lie outside the traditional ambit of contract law) and that directly impact contract formation. For example, it would be impossible for a single convention to address the effect of fraud on the validity of a contract because of the far-reaching ramifications of such fraudulent action. Moreover, the Draft Convention should be considered a “facilitation” tool that impacts domestic systems as minimally as possible. Consequently, the drafters were left to address areas that were within the purview of the committee, which is essentially facilitating the removal of barriers to electronic contracting; they were not charged with rewriting domestic law.

#### B. Writing and Signatures

The major objective of the Draft Convention, as well as the Model Law on Electronic Commerce, was to enable or facilitate the use of electronic communication in contract formation and performance. To do this, both the Model Law on Electronic Commerce and the Draft Convention needed to provide equal treatment to users of paper-based and electronic-based communications. It was therefore first necessary to determine the functions served by the paper-based communication and then replicate that function with respect to electronic communication. This process was expected to facilitate equivalence between the systems. Within electronic con-

tracting, “functional equivalence” can only be achieved if the concepts of a “writing” and a “signature” are also used within the electronic communications system.

The Draft Convention<sup>32</sup> and the Model Law on Electronic Commerce<sup>33</sup> both handle the functionality of writing in a straightforward manner. Writings main function is to allow information to be accessible for future use.<sup>34</sup> To give electronic equivalence to this function, the Draft Convention provides that, when the law requires information to be in writing, that requirement is satisfied by an electronic communication if the information is “accessible so as to be usable for subsequent reference.”<sup>35</sup> Of course, most jurisdictions will want to retain written record requirements in some circumstances, for example when domestic law bars the use of electronic communications. Consequently, the Draft Convention allows contracting states, by the way of declaration or exclusion,<sup>36</sup> to require writing in some circumstances.<sup>37</sup>

Unlike a “writing,” a “signature” fulfills a dual function. It identifies the author of a document (attribution)<sup>38</sup> and it confirms the signatories’ approval of the content of the specific document.<sup>39</sup> Neither of these functions is lost under the Draft Convention. However, unlike the Model Law, which provides specific attribution requirements,<sup>40</sup> the Draft Convention leaves the standard of attribution to the parties and the domestic law. Thus, the Draft Convention includes nothing specific about “attribution” other than to require the existence of a reliable<sup>41</sup> method<sup>42</sup> for identifying the author (i.e., originator) that is appropriate under the circumstances.

The Draft Convention’s failure to define or delineate “attribution” may lead to difficulties in the future as the absence seems to be based on the assumption that a “signature” is the primary means of authenticating authorship. However, this assumption is not true, since authorship can be demonstrated in any number of ways, many of which would not fit within the definition of signature, such as a password. Consequently, the failure to specify what is required to authenticate authorship will lead to varied interpretations<sup>43</sup> as to what types of mechanisms should be labeled as authentication devices.<sup>44</sup> However, any concerns about the potential for an overly broad definition to displace the basic function of a signature are misplaced because the use of “attribution” as an authentication device does not displace the law in relation to signatures; it merely provides an equivalent concept that fits within the larger law, thus leaving the *effect* of the authentication device to be determined under other sources of law.

#### C. Automated Systems

The ability of an automated system, generally through what has been termed to be an “electronic

agent,"<sup>45</sup> to manifest assent has drawn concern from numerous commentators. Although most existing domestic laws do not preclude the use of such a system, none of the existing legal instruments specifically proclaim the validity and/or enforceability of the resulting contracts. For example, the U.N. Convention on Contracts for the International Sale of Goods (CISG) allows the parties to create their own formation rules,<sup>46</sup> which should be interpreted to include the use of "electronic agents." In fact, even the more recently drafted Model Law on Electronic Commerce contains only a general rule on attribution<sup>47</sup> without specifying the validity and enforceability of such contracting. In contrast, the Draft Convention specifies that contracting through the use of automated message systems "shall not be denied validity or enforceability"<sup>48</sup> if the sole reason for such a denial is the fact that "no natural person reviewed each of the individual actions carried out by the systems or the resulting contract."<sup>49</sup> The inclusion of these provisions in Article 12 of the Draft Convention can be interpreted as an attempt to fulfill three purposes: (1) it clarifies the system of attribution in that electronic data that are generated by electronic systems can be attributed to the person who uses the system; (2) it makes clear that electronic systems can manifest intent for the person or entity using the system; and (3) it places the risk of mistakes and errors generated by the automated system upon the person or entity using the system.

#### **D. Time and Place of Dispatch and of Receipt**

Despite numerous concerns surrounding the place of dispatch and of receipt of an electronic communication, both the Draft Convention and the Model Law on Electronic Commerce take the same straightforward approach to the place of dispatch and receipt. An electronic communication is deemed received and dispatched from the place that each party has its "place of business."<sup>50</sup> Consequently, there is no need to determine the location of the server, the system, or the individual sending the electronic communication.<sup>51</sup> All that is required is a determination of each party's "place of business," thus obviating much of the controversy.

The Draft Convention<sup>52</sup> and the Model Law<sup>53</sup> are also essentially the same—except for terminology<sup>54</sup>—in determining when the time of dispatch occurs. Under the Draft Convention, dispatch occurs when the electronic communication "leaves an information system under the control of the originator or of the party who sent it on behalf of the originator."<sup>55</sup> However, the Draft Convention adds the qualification that "if the electronic communication has not left an information system under the control of the originator or of the party who sent it on behalf of the originator, [the time of dispatch is] the time when the electronic communication is received."<sup>56</sup> This additional language was needed to cover situations where parties are communicating

through a Web-based mechanism in which a Web page is used as the medium of communication. In those situations, the message would never leave the system and would thus not be covered by the Draft Convention.

In contrast to the simplicity of determining the place and time of dispatch, determining the time of receipt is not as straightforward and remains controversial.<sup>57</sup> No topic encompasses such a wide range of issues and legal implications. Thus, it should be no surprise that the Draft Convention and the Model Law on Electronic Commerce—despite being drafted by the same overarching governing body—take different approaches on the matter. Of course, this distinction may cause difficulties since any major distinctions can potentially create duality in an otherwise harmonized area of law.

The Draft Convention provides the following:

The time of receipt of an electronic communication is the time when it becomes capable of being retrieved by the addressee at an electronic address designated by the addressee. The time of receipt of an electronic communication sent to another electronic address of the addressee is the time when it becomes capable of being retrieved by the addressee at that address and the addressee becomes aware that the electronic communication has been sent to that address. An electronic communication is presumed to be capable of being retrieved by the addressee when it reaches the addressee's electronic address.<sup>58</sup>

The terminology in this Article requires examination.

First, the Draft Convention uses the phrase "capable of being retrieved" as opposed to the phrase "enters the . . . system," which is found in the Model Law on Electronic Commerce.<sup>59</sup> This distinction shows a fundamental change in the position taken on the receipt of electronic communications because it adds a new level of expectation of the parties. Under the Draft Convention language, the recipient needs to be able to retrieve the electronic communication, which may be read to imply a standard higher than the mere "entering" of the system required by the Model Law on Electronic Commerce. Although the Draft Convention contains a presumption as to when a communication is "capable of being retrieved," the use of the word "capable" implies that the recipient might be determined not to have received an electronic communication if it is unintelligible or unusable or if it contains encoded or otherwise protected information. Clearly, the existence of encoded or otherwise protected information would serve to

rebut the presumption of the communication's being "capable of being retrieved." Consequently, in the situation where a recipient receives an encoded electronic communication, it is possible that, under the Draft Convention, the recipient would be determined to be incapable of retrieving the information, and, thus, receipt would not have occurred.

Second, the Draft Convention provision set out above makes clear that there are two situations to be concerned with: (1) communications received at an electronic address that was specified or otherwise communicated as the primary means of electronic communications, and (2) communications received at an address that was not communicated by the recipient as a preferred electronic address. This distinction is important. If an electronic communication is sent to a party at an address that had not been designated by that recipient, the party will not be deemed to have received the communication, even if the communication had reached the addressee's electronic address, unless and until that recipient becomes aware that the electronic communication had been sent to that address. This is because the recipient did not accept the risk associated with that particular, undesignated address. Thus, for receipt to be deemed to have occurred, any communication to a non-primary electronic address will need to satisfy both requirements: (i) it must be capable of being retrieved by the addressee, and (ii) the addressee must be aware that it has been sent to the undesignated address.

#### E. Errors in Electronic Communications

There is arguably one area of substantive law that is covered by the Draft Convention: the ability of a party to correct input errors. Included in the Draft Convention after much compromise and debate is a provision that allows a party to correct input errors when (1) a natural person makes an input error while interacting with an automated system,<sup>60</sup> and (2) the automated system does not allow that person to correct the error.<sup>61</sup> In such a case, the person who made the error may withdraw the electronic communication if that person (1) notifies the other party within a reasonable time after learning of the error,<sup>62</sup> and (2) has not received a material benefit from the goods or services.<sup>63</sup>

There are several points of interest in the language of this article. First, the use of the term "natural person" is not defined within the Draft Convention but can be assumed, in this context, to mean a natural person as opposed to an automated system.<sup>64</sup> Thus, this provision appears not to apply to input errors made by an automated message system even if a natural person had programmed the automated system. Second, the Draft Convention is clear that the only errors capable of being deemed "in error" are those of an input nature. The use of the term "input" is important for two reasons: (1) it

limits the applicability of the provision to one source of errors, and (2) any displacement of a domestic law is limited to a specific issue, found chiefly in electronic communications.

Finally, the use of the term "withdraw" is intended as a limiting term. Consequently, the party who committed the input error is not expected to "correct" the input error but instead is given the right to withdraw the communication. This is an important distinction since the ability merely to "correct" the input error could result in odd or unfortunate circumstances (for example, if the input error were an integral portion of the communication). Moreover, the terminology recognizes that the majority of legal systems allow a party in error to avoid the effects of the transaction resulting from the error.<sup>65</sup> Providing the party in error with the right to "withdraw" gives that party the right to nullify the communication containing the error.

#### IV. Conclusion

It appears that in many ways the Draft Convention will succeed in removing many of the obstacles that could hinder the widespread use of electronic communications in international contracting. Although the Draft Convention contains new provisions and alters language from the Model Law on Electronic Commerce, there appears to be limited conflict between the numerous documents on the subject. Moreover, the limited scope of the Draft Convention will increase the likelihood of widespread adoption. Clearly, there will be areas that will cause difficulties, and some areas (such as determining the time of formation) are ripe for debate, while other areas have yet to be uncovered. However, none of these difficulties should be a barrier to widespread adoption. Moreover, the frequently cited *bête noire*—the potential consequences of a fraudulent transaction—should be viewed as an issue to be resolved on the domestic front. Thus, this potential barrier to adoption will begin to be eliminated as domestic law is adapted to situations occurring in the electronic world. In short, the Draft Convention should facilitate electronic contracting in the future.

#### Endnotes

1. See United Nations Commission on International Trade Law (UNCITRAL) Draft Convention on the Use of Electronic Communications in International Contracts, G.A. Res. 60/21, adopted on 23 Nov. 2005, U.N. Doc. A/60/21 (9 Dec. 2005), setting out the text of the Draft Convention as an Annex thereto (herein referred to as the "Draft Convention"), accessible at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/2005Convention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/2005Convention.html) (last visited on 23 Jan. 2006).
2. The original group was given a larger purpose, to eliminate barriers to international trade due to inadequate national legislation by enabling or facilitating the use of electronic commerce and by providing for the equal treatment of computer-based information. The Working Group considered proposals for



removing obstacles to electronic commerce in existing international conventions at its 38th session, in 2001, on the basis of a note by the Secretariat (A/CN.9/WG.IV/WP.89).

3. See UNCITRAL Model Law on Electronic Signatures, adopted by UNCITRAL on 5 July 2001. See G.A.Res. 56/80, adopted on 12 Dec. 2001, U.N. Doc. A/RES/56/80 (24 Jan. 2002) (“Model Law on Electronic Signatures”), accessible at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/2001Model\\_signatures.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/2001Model_signatures.html) (hyperlink; last visited on 23 Jan. 2006).
4. See UNCITRAL Model Law on Electronic Commerce, adopted by UNCITRAL on 12 June 1996. See G.A.Res. 51/162, adopted on 16 Dec. 1996, U.N. Doc. A/RES/51/162 (30 Jan. 1997) (“Model Law on Electronic Commerce”), accessible at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/1996Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/1996Model.html) (hyperlink; last visited on 23 Jan. 2006).
5. UNCITRAL Press Release, 15 July 2005, accessible at <http://www.unis.unvienna.org/unis/pressrels/2005/unisl96.html> (last visited on 30 Jan. 2006).
6. See Draft Convention art. 1(1). There are exclusions, such as “contracts concluded for personal, family or household purposes.” Draft Convention art. 2(1)(a). In addition, the drafters decided to exclude any (i) transferable instrument that entitled the bearer or beneficiary to claim the delivery of goods or the payment of a sum of money, and (ii) most financial service sector contracts.
7. See Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 19 (8 Nov. 2004), accessible at <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
8. States are free to make a declaration under Draft Convention art. 19 to limit this possibility.
9. See Draft Convention arts. 1, 3, and 19.
10. Draft Convention art. 4(b) defines “electronic communication” to mean any communication that the parties make by means of data messages.
11. “Communication” is defined to mean any statement, declaration, demand, notice or request, including an offer and the acceptance of an offer, that the parties are required to make or choose to make in connection with the formation or performance of a contract.
12. “Data message” is defined to mean information generated, sent, received or stored by electronic, magnetic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy.
13. That is, as opposed to covering all contracts. See Report of the Working Group on Electronic Commerce on Its 39th Session U.N. Doc. A/CN.9/509, para. 22 (21 Mar. 2002).
14. See Report of the Working Group on Electronic Commerce on Its 39th Session U.N. Doc. A/CN.9/509, para. 43 (21 Mar. 2002).
15. See Draft Convention art. 1(2).

There has been debate about this provision since other Conventions (e.g., U.N. Convention on the Carriage of Goods by Sea, 1978—the “Hamburg Rules” accessible at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/transport\\_goods/Hamburg\\_rules.html](http://www.uncitral.org/uncitral/en/uncitral_texts/transport_goods/Hamburg_rules.html) (hyperlink; last visited on 30 Jan. 2006)) provide that a failure of the parties to designate a location should not impact the legal characteristics of the document. Under the Draft Convention, it is possible that, if parties from different states fail to disclose their locations, unfavorable domestic law that fails to recognize electronic communications might apply. Of course, application of such domestic law would defeat the purpose of the Draft Convention. For this reason, the

issue of creating a “duty to disclose” was debated during the Nov. 2003 session. See U.N. Doc. A/CN.9/WG.IV/WP.104 (8 Sept. 2003), accessible at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/4Electronic\\_Commerce.html](http://www.uncitral.org/uncitral/en/commission/working_groups/4Electronic_Commerce.html) (hyperlink; last visited on 30 Jan. 2006).

16. Under the Draft Convention, the default rule establishes that the party’s place of business is to be that which has the “closest relationship to the relevant contract.” Draft Convention art. 6(2). A party failing to designate its place of business but having only one place of business will be presumed to be located at that place of business. *Id.*
17. Draft Convention Art 4(h). Non-transitory is considered to encompass a “stability” business location where economic activity occurs. Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 87 (8 Nov. 2004), accessible at <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 30 Jan. 2006).
18. The Organization for Economic Cooperation and Development (OECD) Committee on Fiscal Affairs determined that an Internet Web site, which is a combination of software and electronic data, “does not in itself constitute tangible property and therefore does not have a location that can constitute a ‘place of business as there is no ‘facility such as premises or, in certain instances, machinery or equipment’ [...] as far as the software and data constituting that web site is concerned.” Organization for Economic Cooperation and Development, *Clarification on the Application of the Permanent Establishment Definition in E-commerce: Changes to the Commentary on the Model Tax Convention on Article 5* (accessible at [www.oecd.org/dataoecd/46/32/1923380.pdf](http://www.oecd.org/dataoecd/46/32/1923380.pdf)), cited in Legal Aspects of Electronic Commerce. Electronic Contracting: Background Information, A/CN.9/WG.IV/WP.104, paras. 12-14 (8 Sept. 2003), accessible at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/4Electronic\\_Commerce.html](http://www.uncitral.org/uncitral/en/commission/working_groups/4Electronic_Commerce.html) (hyperlink; last visited on 30 Jan. 2006).
19. See Draft Convention Art 6(5). For example, .com and .net. Legal Aspects of Electronic Commerce. Electronic Contracting: Background Information, A/CN.9/WG.IV/WP.104, paras. 19-20 (8 Sept. 2003), accessible at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/4Electronic\\_Commerce.html](http://www.uncitral.org/uncitral/en/commission/working_groups/4Electronic_Commerce.html) (hyperlink; last visited on 30 Jan. 2006).
20. See Draft Convention art. 19.
21. See Draft Convention arts. 19(1) and 21 (1).
22. See Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 32 (8 Nov. 2004), accessible at <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
23. CISG was adopted by diplomatic conference on 11 April 1980. It is accessible at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html) (hyperlink, last visited on 23 Jan. 2006).
24. “[A]rticle 11 establishes the principle that the formation and the evidence of a contract subject to the Convention (CISG) is free of any form requirement, and therefore can be concluded orally, in writing or in any other way. As a result, exchange of e-mail messages should suffice to form a contract under the United Nations Sales Convention, an opinion to which most legal writers have subscribed.” Legal Aspects of Electronic Commerce. Possible Future Work in the Field of Electronic Contracting: an Analysis of the United Nations Convention on Contracts for the International Sale of Goods, U.N. Doc. A/CN.9/WG.IV/WP.91 para. 31 (9 Feb. 2001). Of course, issues regarding electronic contracting issues, such as the treatment of virtual goods, remain, but amending the substantive law was not a goal of the Draft Convention.

25. The “New York Convention” was adopted by diplomatic conference on 10 June 1958 and became effective in 1959. It is *accessible at* [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html) (hyperlink; last visited on 23 Jan. 2006).
26. *See* Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 53 (8 Nov. 2004), *accessible at* <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
27. New York Convention arts. II and IV(1)(b).
28. Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 132 (8 Nov. 2004), *accessible at* <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
29. *Id.*
30. That is not to say the drafters did not consider the issue. For example, see Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 53 (8 Nov. 2004), *accessible at* <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
31. *Id.*
32. Draft Convention art. 9(2).
33. Model Law on Electronic Commerce art. 6.
34. Admittedly, this is an oversimplification. Some commentators argue that a writing serves numerous purposes; for example, in the civil law, a writing serves a warning function; in the common law, it serves an evidentiary function. However, the drafters of both the Model Law on Electronic Commerce and the Draft Convention determined that one function could encapsulate many of these other functions, and in fact may be the primary function of a writing: the information must be accessible for future use. Therefore, they rightly used this as the primary function. For discussion, *see* UNCITRAL Model Law on Electronic Commerce with Guide to Enactment 1996 (with additional article 5 *bis*, as adopted in 1998) paras. 48-52, U.N. Sales No. E.99.V.4 (U.N. 1999), *accessible at* [http://www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/1996Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/1996Model.html) (hyperlink).
35. Draft Convention art 9(2).
36. Draft Convention art. 19(2) provides for such exclusion by way of declaration pursuant to Draft Convention art. 21.
37. *See* Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 126 (8 Nov. 2004), *accessible at* <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
38. *See* Draft Convention art. 9(3)(a).
39. *See id.*
40. *See* Model Law on Electronic Commerce art. 13.
41. *See* Draft Convention Art 9(3)(b).
42. *See id* art. 9(3)(a).
43. For example, the use of passwords as authentications devices has caused difficulties in situations where the court questioned the reliability of a password because such devices are easily manipulated and stolen. Amtsgericht Erfurt, Case No. 28 C 2354/01, 14 Sept. 2001, *JurPC—Internet Zeitschrift für Rechtsinformatik*, *JurPC WebDok* 71/2002, *accessible at* <http://www.jurpc.de/rechtspr/20020071.htm> (last accessed on 25. Jan. 2006); Landgericht Konstanz, Case No. 2 O 141/01 A, 19 Apr. 2002, *JurPC—Internet Zeitschrift für Rechtsinformatik*, *JurPC WebDok* 291/2002, *accessible at* <http://www.jurpc.de/rechtspr/20020291.htm> (last accessed on 25 Jan. 2006), *cited in* Legal Aspects of Electronic Commerce. Electronic Contracting: Background Information, A/CN.9/WG.IV/WP.104/Add.3 para. 16 (8 Sept. 2003), *accessible at* [http://www.uncitral.org/uncitral/en/commission/working\\_groups/4Electronic\\_Commerce.html](http://www.uncitral.org/uncitral/en/commission/working_groups/4Electronic_Commerce.html) (hyperlink; last visited on 30 Jan. 2006).
44. Many of the courts that question passwords as authentication devices have overlooked authentication as a presumption and have questioned the presumption itself. Instead, the courts should recognize the ability of a presumption to be rebutted under the facts of a particular case. Of course, there is nothing to prevent the presumption of authorship to be rebutted in instances of stolen passwords or fraudulent e-mail authorship. The law has similar deceptive-practice provisions in place within the paper-based world, and there is nothing to prevent functional equivalents in electronic communications.
45. Tragically, this terminology persists despite the inappropriateness of the analogy between an automated system and a sales agent.
46. *See* CISG, note 23 *supra*, art. 9.
47. Model Law on Electronic Commerce art. 13(2)(b). Attribution is the process by which parties can determine the author of electronic communication. The Model Law on Electronic Commerce provides that, as between the sender and the recipient, an automated data message is deemed the message as that of the sender, provided that the sender programmed—or authorized another to program—the information system. *Id.*
48. Draft Convention art. 12.
49. *Id.*
50. Draft Convention art. 10(3); Model Law on Electronic Commerce art. 15(4).
51. “Place of business” means any place where a party maintains a non-transitory establishment to pursue an economic activity other than the temporary provision of goods or services out of a specific location.” Draft Convention art. 4(h).
52. Draft Convention art. 10(1), discussed in the text at notes 54 and 55 *infra*.
53. The Model Law on Electronic Commerce provides that “unless otherwise agreed between the originator and the addressee, the dispatch of a data message occurs when it enters an information system outside the control of the originator or of the person who sent the data message on behalf of the originator.” Model Law on Electronic Commerce art. 15(1).
54. The major terminology distinction occurs because the Draft Convention takes a more current medium neutral approach. Thus, the Draft Convention uses the term “electronic communication” where the Model Law on Electronic Commerce uses the term “data message.” The difference is that a data message is more limited than an electronic communication. The major distinction between the two terms is important since a “data message” encompasses a wide range of media beyond purely “electronic” ones. Consequently, a data message would include not only electronic communications, such as e-mail, but also an older medium such as telex. However, the distinction should not impact the majority of issues.
55. Draft Convention art 10(1).
56. *Id.*
57. The Working Group noted that no other provision in the Draft Convention had generated the same amount of debate within the Working Group as draft paragraph 2. *See* Report of the Working Group on Electronic Commerce on Its Thirty-Ninth Session (New York, 11-15 Mar. 2002), U.N. Doc. A/CN.9/509,

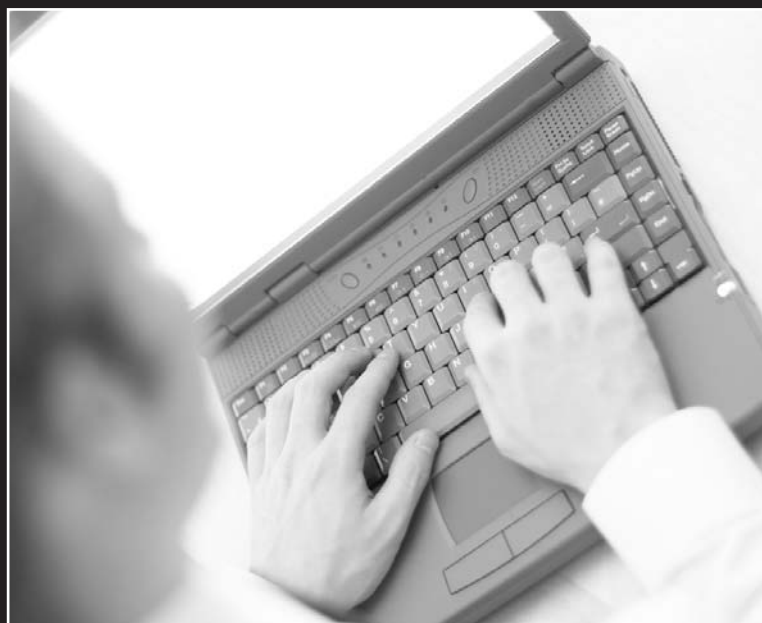
paras. 94-98 (21 Mar. 2002); Report of Working Group IV (Electronic Commerce) on the Work of Its Forty-First Session (New York, 5-9 May 2003), A/CN.9/528, paras. 141-151 (19 May 2003); and Report of the Working Group on Electronic Commerce on the Work of Its Forty-Second Session (Vienna, 17-21 Nov. 2003), A/CN.9/546, paras. 61-80 (8 Dec. 2003); Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), A/CN.9/571 paras. 145-161 (8 Nov. 2004), all accessible at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/4Electronic\\_Commerce.html](http://www.uncitral.org/uncitral/en/commission/working_groups/4Electronic_Commerce.html) (hyperlinks; last accessed on 26 Jan. 2006).

- 58. Draft Convention art. 10(2).
- 59. Model Law on Electronic Commerce art. 15(2)(a)(i).
- 60. See Draft Convention art. 14(1).
- 61. See *id.*
- 62. See *id.* art. 14 (1)(a).

- 63. See *id.* art. 14(1)(b).
- 64. According to the Commentary of the Working Group, "natural persons," although undefined, is appropriate "in those substantive provisions of the draft convention that required a distinction between legal entities and natural persons." See Report of the Working Group on Electronic Commerce on the Work of Its Forty-Fourth Session (Vienna, 11-22 Oct. 2004), U.N. Doc. A/CN.9/571, para. 89 (8 Nov. 2004), accessible at <http://www.uncitral.org/uncitral/en/commission/sessions/38th.html> (hyperlink; last visited on 23 Jan. 2006).
- 65. See *id.* para. 193.

**Anjanette H. Raymond, J.D., LL.M., is a lecturer in International Commercial Law at the Centre for Commercial Law Studies at the University of London.**

## A Pro Bono Opportunities Guide For Lawyers in New York State *Now Online!*



Looking to volunteer? This easy-to-use guide will help you find the right opportunity. You can search by county, by subject area, and by population served. A collaborative project of the Association of the Bar of the City of New York Fund, New York State Bar Association, Pro Bono Net, and Volunteers of Legal Service.

*powered by* **probono.net**

You can find the Opportunities Guide on the Pro Bono Net Web site at [www.probono.net/NY/volunteer](http://www.probono.net/NY/volunteer), through the New York State Bar Association Web site at [www.nysba.org/volunteer](http://www.nysba.org/volunteer), through the Association of the Bar of the City of New York Web site at [www.abcnyc.org/volunteer](http://www.abcnyc.org/volunteer), and through the Volunteers of Legal Service Web site at [www.volsprobono.org/volunteer](http://www.volsprobono.org/volunteer).



NEW YORK STATE  
BAR ASSOCIATION



**VOLS**  
Volunteers of  
Legal Service



# M&A in Argentina in the Last Decade: Boom, Crisis and Resurgence

By Alberto Navarro

## I. Introduction

The present article describes some general aspects of M&A activity in Argentina during the past few years, and the way in which the salient features of M&A, as established in the 1990s, have been changing as a reaction to the macro-economic changes that the Argentine financial crisis of the end of 2001 brought about.

## II. The 1990s: Perfect Conditions for a Boom of Local and Cross-Border M&A

The 1990s are remembered in Argentina mostly as the years that led to the opening and modernization of the Argentine economy. Argentina, as the second-largest country in South America, with a population of nearly thirty-seven million, a ninety-five percent literacy rate, and a per capita GDP of about \$7,500 (probably the highest in Latin America), was the perfect candidate for the entrance of different forms of foreign investment aimed at the acquisition of local companies. Thus some pioneer private equity funds started investing in Argentina at the very start of the 1990s.<sup>1</sup>

Contrary to today, Argentines in the 1990s could see, probably for the first time ever, all sorts and types of acquisition transactions. This was partly a result of the interest of investors (and worldwide strategic players in general) in the acquisition of private companies offering good growth opportunities. But it was also partly a result of the investment opportunities created by the privatization of formerly state-owned companies, a process led by former President Carlos Menem. Argentina also used the occasion to adapt its local legislation to a new investment environment, as it attempted to become increasingly attractive to a world that, at the beginning of that decade, looked at Latin America with increasing interest, probably without even imagining an opening in Eastern Europe or Asia.<sup>2</sup>

It is worth mentioning that a key and influential factor of this boom<sup>3</sup> was the way in which the then government faced the process of the globalization of financial markets. From the very beginning the government sought to assure the stability and growth of the economy through the “convertibility system,” an initiative of then Economics Minister Domingo Cavallo. The plan was highly successful in reducing inflation to practically zero, after decades of high rates, by pegging the Argentine *peso* to the U.S. dollar on a one-to-one basis,

which allowed for the stabilization and strengthening of Argentina’s economic system and its financial performance. Then stability and growth prospects, in turn, promoted the opening of new markets and a chance to compete for many companies who decided to start businesses in Argentina. Also, the proposed creation of a common market among Argentina, Brazil, Paraguay and Uruguay was seen as an influential factor that had the potential to permit companies installed in those countries access to a market of more than 240 million consumers.<sup>4</sup>

These profitability and growth possibilities prompted the purchase of companies, many of which were family owned, with strong brand names and cash flows, and which were both financially sound and well organized.<sup>5</sup>

As for the Argentine privatization process, by the end of 1989 the new government was promoting the idea of giving operating concessions in or selling outright many highly inefficient state-owned public utility companies to major international strategic players in their respective fields.<sup>6</sup> In addition, as part of a strategy to attract capital after decades of political instability, Argentina signed various bilateral investment treaties (“BITs”) with many countries to promote and protect investments.<sup>7</sup>

This change of hands in companies, favored by both the international and the local business, financial and monetary communities, led to the massive entry into Argentina of strategic investors, with the result that certain Argentine transactions came to be case studies at renowned universities worldwide.<sup>8</sup>

Unfortunately, by the end of the year 2000, disillusionment with Argentina had set in: investor confidence was eroded by the continuing Argentine recession, which was exacerbated by a rolling series of external events, including the Russian financial crisis of 1998 and the currency devaluation in Brazil in early 1999.<sup>9</sup> At the same time Argentina still had an economy highly dependent on agricultural and commodity exports. These external crises, combined with a lack of control over fiscal accounts and an excessive growth of public debt to finance overspending by the government, caused the convertibility system to fail, in spite of the efforts of then President De la Rúa at the end of 2001 to restore investors’ and consumers’ confidence.<sup>10</sup>

### III. The Perfect Storm: M&A Amidst the Argentine Crisis

While many of the achievements of the 1990s described above looked impressive, Argentina's economic history had been characterized by substantial missed opportunities. Thus after a peak of economic prosperity at the beginning of the twentieth century, which allowed Argentina to be ranked ninth among the world's nations in terms of wealth, a process of decline had taken place since the 1950s. For instance, after many global financial institutions had loaned so widely to Argentine businesses and governments, the 1970s and the 1980s were characterized by the failure of international banks to collect on those loans and the banks found themselves with substantial portfolios of non-performing loans by the late 1980s.<sup>11</sup> As opposed to the great failures in the preceding decades (the 1980s were called "the lost decade"), the major macro-economical, political and regulatory changes in the 1990s led many to think that the new economic conditions established in the country could be expected to become, for the first time, irreversible, giving the idea that the growth in the private equity industry in those "golden years" was destined to last for a long time. The great mistake, committed by economists, lenders and investors, was to believe that Argentina was on the right path forever.

In any event, the spectacle of large transactions, with investors coming from abroad and paying prices based on high multiples, was followed by an unprecedented generalized financial, banking and debt crisis, aggravated by the highly dollarized economy, the lack of fresh funds, and a prolonged recession. The initial consequences of this crisis for Argentina were Argentina's overindebtedness and fiscal disorder, which in turn led to the most important declaration of default in Argentina's history, both at the national and the provincial level, and in the public as well as the private sector.<sup>12</sup>

This default declaration also meant the devaluation of the Argentine *peso*<sup>13</sup> and the resulting initial loss of four hundred percent of its value. Argentina was accused of breaching many contracts it had previously entered into through, among other things, its asymmetric pesification of obligations, which triggered a change in all sorts of legal, contractual and judicial rules, and its enactment of a broad range of legislation that created many legal restrictions in many areas, such as foreign exchange and financial and credit rules. This led to all sorts of legal actions, mainly arbitration procedures before the ICSID, which is the arbitration tribunal of the World Bank. As a result of the execution of the many BITs, Argentina had accepted the exclusive jurisdiction of the ICSID.<sup>14</sup>

In addition to the actions filed as a result of the change of contractual rules and the breach of BITs,<sup>15</sup> there was the additional pressure on Argentina by holders of sovereign debt that was in default. Thus even after the successful debt swap ended on 25 February 2005, there were still holdouts, holding more than US \$23 billion of debt, whose claims are yet to be resolved.

As a result of this chaotic situation, the profile of M&A transactions in the period after the crisis changed drastically from the profile of M&A transactions before the crisis, and a restructuring of the whole private equity industry followed. Foreign investment funds that had been so active during the 1990s were forced to review strategies in the face of this new reality. Some funds left the Argentine market, while others engaged in controlling their remaining stockholdings (which had lost substantial value) or refocusing their investments toward other sectors.

The withdrawal of investors and big players from Argentina as a result of the crisis was seen as sending a negative message to the international investment community. In addition, the crisis made Argentina unable to take advantage of the recovery that the Latin American economy started to enjoy by the end of 2002. That was due to the fact that both the lack of early restructuring of the public debt and the lack of an agreement with the IMF caused Argentina to lose opportunities for growth that other countries of the region, such as Brazil, were able to seize.<sup>16</sup>

All of the above teaches that changes cannot be consolidated easily and that such changes must be carried out not only by a single government, but also by subsequent governments, and must be accepted by society as a whole. Unfortunately, that did not happen in Argentina, where the positive changes in the 1990s did not create in the minds of the general Argentine public a feeling of growth and well-being. Indeed, on the contrary, these changes were blamed for increased poverty.<sup>17</sup>

The unstable economic conditions described above explain why most major transactions during the Argentine crisis were mainly private debt restructurings and changes of control.<sup>18</sup> That was so because the debt/ebitda relationships within many enterprises became so unsustainable that numerous restructurings turned out to be unsuccessful and led to a process of change of ownership in companies, most of which were subject to bankruptcy laws. In this sense, it is worth noting that the acquisition of companies in the course of reorganization proceedings (*concurso preventivo*) is often called an "Argentine cramdown," a trend that is still ongoing and is likely to continue for the next few years.<sup>19</sup>

It may be observed that transactions in this new scenario have been characterized by lower prices (prob-

ably as a result, among other reasons, of the general loss of value of companies, assets and tradable goods in general due to the devaluation of the currency) and even on a cashless basis. This trend is a result of the debt-into-equity swaps by creditors and opportunistic acquirers, who took advantage of good prices and opportunities by injecting working capital into strongly indebted and defaulted companies as a means of buying them out at high discount rates.<sup>20</sup>

#### **IV. The Aftermath of the Crisis: The New Impulse; Some Threats to Transactions**

Obviously, this economic and financial tsunami changed the profile of not only the transactions but also the participating investors.

Regarding its profile of investors, it may be said that Argentine M&A in the aftermath of the crisis featured the withdrawal of the strategic and financial investors from the 1990s and their replacement by new investors.<sup>21</sup> In this connection, new investment funds emerged, in many cases controlled by local investors who, as newcomers, have come to be called the “new Argentine bourgeoisie.”<sup>22</sup> In the case of strategic investors, certain regional investors have come to the forefront, such as Brazilian companies that have paid significant prices for Argentine companies,<sup>23</sup> as well as many Argentine families who had sold their companies during the 1990s and could later reacquire them at prices lower than those for which they had been sold.<sup>24</sup>

Secondly, since 2002 M&A transactions have been focused mainly in real estate and natural resources (mainly oil and gas), where there is always a place for strategic acquisitions, regardless of the economic and financial circumstances. Since 2002 M&A has gradually come to be oriented toward agro-industrial companies with clear export potential, something which has contributed to the growth of Argentina’s GDP during the period 2003-2005, and industries such as tourism and viticulture, which have been the target of cross-border investors, most recently by Chileans acquiring resources related to the wine industry.

The principal threat to transactions and investments in general today is the sense of uncertainty that still defines the image of Argentina in the rest of the world. This is a result of both the default in Argentina’s sovereign debt as well as the breach of many contracts mainly entered into with investors in utilities in Argentina, many of whom have since abandoned the companies and have been suing the country on various grounds, such as unilateral change of rules and expropriation of companies. The fear of this happening again has not completely disappeared, in spite of the extraordinary performance of the Argentine economy during the last three years.

This sense of uncertainty is particularly noticeable in the legal field, where attorneys, when advising investors on the lawfulness and risks of projects, are now generally forced to contend with certain risks and variables that do not necessarily depend on the application of laws.<sup>25</sup>

One other threat can also be found in draft antitrust legislation sent to Congress by the current government in September 2005. This proposed legislation states that the final decision regarding the approval of mergers and acquisitions will be exclusively entrusted to the executive branch. This proposal will cause a great debate in view of the uncertainties that the enactment of such legislation would create for relevant buyers, due to the great discretionary power given exclusively to the Economics Ministry.<sup>26</sup>

In any event, we note that, although the Argentine government is devoted to attracting local and international investment, in fact the volume of investment in relation to the Argentine GDP is still below what economists generally refer to as the “capital replacement level.”

#### **V. M&A in Argentina from 2005 on**

Satisfactory levels of M&A activity involving Argentina—and the needed substantial increase in investments back up to the levels achieved prior to the crisis—will in the end depend on the restoration of full confidence in Argentina as a leading economy in Latin America. However, that is something which, in spite of Argentina’s important economic achievements in the last thirty-six months, appears not yet to have occurred.

In this sense, the regaining of the full trust of the international community is vital if Argentina is to become again a preferred destination for investment. This is especially so now, when private equity investors more than ever can look at several options throughout a globalized new world with new rules of the game for investment.

But on a positive note, Argentina has shown with its extraordinary economic results that it has the capacity to make a significant and speedy recovery and to continue to be attractive to the world in many sectors and industries like those mentioned above,<sup>27</sup> even in the aftermath of the deepest economic crisis in Argentina’s entire history as an independent nation. This is true despite President Kirchner’s tough stance toward the international community, including the IMF, and toward some local business sectors, such as by freezing utility rates. Nevertheless such hostility by the Argentine government has so far not proved an obstacle or deterrent to the increasing level of investment and M&A activity during the last two years.



In this respect, it is worth noting that significant amounts have been paid for the acquisition of some companies during the past year, something that cannot be easily separated from the impressive improvements that the Argentine economy has shown.<sup>28</sup>

Moreover, although the number of transactions and the amounts paid in such M&A transactions are significantly lower than the equivalent figures achieved in the period 1994-1999,<sup>29</sup> it is also true that the number of transactions has recently increased significantly.

Thus, while approximately twenty-three M&A transactions were registered in 2002 (with an aggregate value of approximately US \$2.1 billion, most of which was the result of restructurings at the company level), approximately fifty-nine were registered in 2003 (for approximately US \$1.65 billion), and around ninety-four (for approximately US \$2.6 billion) in 2004. As for the year 2005, there will probably be around one hundred transactions, according to reliable data,<sup>30</sup> and the total transaction value will increase significantly to an estimated US \$3.5 billion.

Recent available data suggest an optimistic trend in the M&A industry for 2006.<sup>31</sup> That optimism is partly based on the increasing strategic presence of some leading multinational companies who have settled in Argentina in the last two years, such as the Brazilian Camargo Correa Group, which purchased the giant company Loma Negra this year, as well as the acquisition by Brazil's Petrobras of the oil and gas division of the leading conglomerate, Perez Companc, in 2003-2004. The value of each of these transactions exceeded US \$1 billion. Brazilian investors were the largest investors in Argentina in 2005, paying approximately thirty-six percent of the total transaction value.<sup>32</sup>

Telecommunications, construction, public services (energy), and food and beverages were the most active sectors in 2005 for M&A.<sup>33</sup> Although Argentine investors played the leading role in most of the 2005 deals (approximately forty-one percent of the total, the biggest presence by Argentine investors in nine years according to research conducted by KPMG), their participation constituted only approximately twenty-four percent of the total M&A value.

As observers suggest, strategic players from Spain and India are expected to come into Argentina in 2006, at the same time as regional strategic players, mainly coming from Brazil, Chile and also Mexico, continue to increase their stakes in local companies. But it may take a longer time for investors coming from the US and most parts of Europe to return, since this latter group still must recover from the bad memories left by the crisis.<sup>34</sup>

Despite so much good news, all these impressive achievements nevertheless appear to be insufficient to create the necessary environment for foreign investment so as to move the M&A market beyond the specific opportunities seized these past few years by mainly sophisticated investors, since there appear to be many who still believe that investment in Argentina is still mainly undertaken by those who understand and are willing to live with certain significant risks.<sup>35</sup>

Nevertheless, the future of transaction opportunities in Argentina may depend on how Argentina decides to play the so-called "capitalistic game." It is worth noting that countries like Chile and Brazil, whose governments are headed by presidents traditionally seen as socialist or even populist, have always put aside any kind of ideologies when dealing with economic matters, the G7, the IMF and the developed world in general. These countries, when dealing with such economic and financial matters, become pragmatic and orthodox, with the result that they attract important flows of investment toward their countries. China is another clear example in this respect, even if outside the region.<sup>36</sup>

It may be up to our President to follow some of these examples to try to tackle Argentina's "mood" issue and to try to seduce the international economic and financial world in the same professional way he managed the economy in such an unprecedented positive fashion in recent years.<sup>37</sup>

That may be a challenge and a goal at the same time, but a necessary one if Argentina is to regain in the medium term the confidence of the world's capital and the financial markets and again attract significant amounts of capital and foreign investment to Argentina's M&A market.

## Endnotes

1. Among the private equity funds that took a leading role were The Exxel Group, Boston Capital, JP Morgan Partners Latin America, Innova, BISA-TCR, Fiducorp, Darby Overseas, and DLJ Merchant Banking Partners. During the 1990s, "buyout" funds experienced a one thousand percent increase. While the purchases of leveraged companies aggregated US \$9,600,000 in 1992, by 1999 they reached their maximum amount historically with a volume of US \$63,400,000. *Fondos de private equity: en qué fallan*, APERTURA (October 2001) at 25.
2. In this sense, it is worth mentioning Executive Order 1853/93, which amended Law 21,382 on foreign investments and favored the entry of foreign capital into the country and its exit without a single restriction. Another example of changes in local legislation was Law 23,576, which established a system of issuing negotiable instruments to commercial companies providing for fiscal benefits to those corporations that publicly offered their bonds. And consider Law 24,441, regulating financial trusts, which were seen as an important vehicle to allow all sorts of asset-backed securitization transactions. The number of laws

and regulations aimed at deregulating the economy and having the effect of making Argentina attractive to the world was significant and makes it possible to appreciate the extent to which Argentine endeavored to open its economy and companies to the world, leaving behind anachronistic legislation of the 1970s and the 1980s.

3. In 1999 the value of M&A transactions in Argentina reached approximately US \$21 billion, which, compared to the previous volumes (on average US \$3 billion per year), showed an unprecedented growth in activity in the decade. See APERTURA (September 2003) at 14.
4. On 26 March 1991, Argentina, Uruguay, Brazil and Paraguay signed the *Asunción Treaty*, creating *Mercosur*.
5. See *Companies and Finance: The Americas*, FINANCIAL TIMES, 3 December 1996; *Argentine Buyout King Broadens Realm*, THE WALL STREET JOURNAL, 24 October 1996, available at <http://online.wsj.com>.
6. This was the case with the national telephone company, ENTEL, which was divided into two big companies: Telecom Argentina was sold to French investors, and Telefónica de Argentina was sold to Spanish investors. In addition, the local airline, Aerolíneas Argentinas, was sold mainly to Spanish investors, while Chilean and US investors played a leading role in the privatization of electric power generation, transportation and distribution services in practically the whole country. See *The Henry Kravis of Argentina*, INSTITUTIONAL INVESTOR (August 1997); *Carving out some Profitable Niches*, FINANCIAL TIMES, 1 July 1997.
7. Argentina signed fifty-three BITs in an attempt to induce investments by investors from signatory countries, which included, among others, France, Germany, Italy, Spain, United Kingdom, Canada, United States of America, Israel, Australia, China, Indonesia, Malaysia, Mexico and South Africa. See *Argentine Ministry of Economy Foreign Investment: A Latin American Framework Comparison* (2003). This strategy is criticized today, on the ground that BITs are not necessarily key in encouraging investment. For example Brazil, without having signed any BITs, was capable of attracting substantial investments.
8. In early 1997, a case related to The Exxel Group's successful strategy in acquiring MasterCard's licensee company in Argentina, Argencard S.A., was discussed at the Harvard Business School. Harvard Business School Case N9-297-103, 13 April 1997. Other *Exxel* cases followed and have been taught in other prestigious business schools such as those at the University of Pennsylvania and Columbia University.
9. This is without mentioning the Mexican devaluation of 1994, which had put to test the then weak Argentine financial system.
10. J. Lerner, *et al.*, VENTURE CAPITAL AND PRIVATE EQUITY at 377 (3d ed. 2005).
11. *Id.* at 374.
12. On 23 December 2001, after the resignation of President Fernando de la Rúa, the Legislative Board appointed Adolfo Rodríguez Saá as President of Argentina, who declared the Argentine financial default, stopping payment of the Argentine public debt.
13. In early 2002, Executive Decree 214/02 and Law 25,561 declared the *pesification* of deposits and loans entered into in hard currency.
14. According to the ICSID's List of Pending Cases, thirty-five such claims based on breach of contract are pending. Today Argentina, as a result of the so-called 2001 "emergency legislation," faces claims before this World Bank Arbitration Tribunal that aggregate approximately US \$20 billion. In a recent decision of the ICSID (known as the "CMS" case), the ICSID affirmed that the devaluation following the 2001 crisis caused a deterioration of the income of companies, dismissing arguments by the Argentine government that the emergency measures taken during the economic crisis were suffered by every Argentine citizen, and not only by investors from abroad. The ICSID then affirmed that Argentina had changed the rules of the game, ruling that "the freezing on tariffs and devaluation negatively affected TGN [the company in the cited case], resulting in a tariff neither just nor equitable." As a central aspect of the Argentinean defense in the case, the country asserted that the extreme degree of the economic crisis made it necessary for Argentina to adopt such emergency measures, such as devaluation and tariff freezing, but the ICSID did not agree with that argument, holding that "a serious crisis may not necessarily be equated to a situation of total collapse." Other arguments by plaintiff based on expropriation were rejected.
15. See G. Breuer Newsletter, August 2005, available at [www.gbreyer.com.ar](http://www.gbreyer.com.ar).
16. See "And the money kept rolling in . . .," BUENOS AIRES HERALD, 19 February 2005, citing several articles published by the *Financial Times* on Argentina's "astonishing" economic crisis. The articles also criticized the IMF, which, in the opinion of some scholars and authors, capriciously imposed fundamentalist free-market policies on the country, and then abandoned Argentina to chaos when the free-market policies failed.
17. The impact of the crisis was so pervasive that for the first time more than half of the country's population was classified as "poor." Also, according to the INDEC (*Instituto Nacional de Estadística y Censos*), 26.4% of the population was unemployed or under-employed in the period 2002-2004.
18. Major local companies, such as Telecom, Multicanal, Cable-Visión, Banco Hipotecario, CTI, AUSOL, TGS, Transener and Acindar, engaged in debt restructuring. Many of these companies were able to revolve their debts through pre-packaged bankruptcy proceedings. Recently, Telecom, through a partial out-of-court proceeding, concluded what was by far the largest private restructuring in Argentina, valued at more than US \$2.3 billion.
19. In Argentina, the cramdown differs from the general notion of the term "cramdown power." In the process of restructuring the liabilities of a company that has difficulties in facing its obligations (*concurso preventivo*), there is a stage prior to liquidation if the company fails to obtain approval of its refinancing offer. In such a case, Section 48 of Law 24,522 enables the creditors to take control of the company by making a proposal satisfactory to the other creditors, based on paying the value of the company less its liabilities. Today, after an amendment introduced by Law 25,589, this process is also open to the debtor on a *pari passu* basis with the creditors.
20. Of course, highly indebted companies which had little chance of being restructured by their former owners were also subject to acquisition. An interesting case was Musimundo. The national private equity fund, Pegasus, acquired the company from its creditors, which included Citibank, Galicia, Société Generale and Rio, who had gained control of the company after the Exxel Group gave up control. The transaction was conducted on the basis of the purchase of US \$100 million in debt. Among various other examples are the acquisitions of CTI Móvil and Fargo, which included the purchase of debt in the amounts of US \$250 million and US \$27 million, respectively. See EL CRONISTA ABOGADOS CORPORATE, 14 October 2003, at 19.
21. See APERTURA (October 2003).
22. Among the most active local funds are Dolphin (which purchased Edenor), Transener and Hidroeléctrica Piedra del Aguila as well as Pegasus Capital (which purchased Freddo and Musimundo), and DyG (which acquired Havana). See FORTUNA, 1 September 2003.
23. See Part V *infra*.

24. On 19 December 2003, the local Wertheim group acquired forty-eight percent of the shareholdings in Telecom Argentina for US \$125 million. Telecom France, after more than a decade, withdrew its operations from the country, filing a suit before the ICSID. FORTUNA, 23 December 2003, at 33.

25. As to the role of the lawyers engaged in M&A activities, one may say that the crisis and the different circumstances faced lately have led lawyers to learn several lessons and to take additional precautions in due diligence. Thus, while transactions before the Argentine crisis were larger and more complex, they were at the same time relatively easier transactions to carry out, as compared with today's lower priced but more cumbersome deals. Currently, there is a need for more organized teams of specialized attorneys, with multidisciplinary and international vision, and the crisis factor has added all sorts of complexity, including more paperwork. The information that must be dealt with has become more and more complex. See *Los mejores deals del 2005*, EL CRONISTA ABOGADOS CORPORATE, 19 December 2005, at 1.

In 2004, the Supreme Court of Justice rendered judgment in the case "*Bustos, Alberto Roque y otros c/ Estado Nacional y otros s/ amparo*," declaring the constitutionality of the asymmetric pesification of agreements, two years after the crisis and in contradiction to the precedents of "*Smith*" and "*Provincia de San Luis*" issued by the same court upholding the validity of dollar-denominated payment obligations.

26. This draft law states that the decision on whether an economic concentration affects the general interest of the Nation or has great impact on the use of investment is to be made by the Ministry of Economics. In addition to complying with the requirements under the law, a new discretionary requirement, difficult to measure, must be fulfilled. In addition to this new requirement, the draft provides for the elimination of the proceeding for automatic approval of certain transactions by the executive power. It may be said that the uncertainty caused by this draft law will hardly contribute to the growth of investment. As reputed scholars have affirmed, this draft, if enacted, will increase the costs and risks of investing in Argentina, thereby retarding the return of funds that Argentine residents deposited abroad. See EL CRONISTA ABOGADOS CORPORATE, 29 August 2005, at 4.

See the September 2005 monthly issue of G. Breuer's Newsletter:

Last August 17, the National Executive Power sent to Congress a draft to amend the Antitrust Law (Law N° 25,156). Under wording of the proposed amendment to Section 13 of such law, the Secretary of Technical Coordination is empowered to propose to the Economy Minister the review of any final decision taken by the Antitrust Court in case of economic concentrations in the area of utilities, defense, energy or mining, or where the operation in question has great impact on employment or investment. This would give the Economy Ministry a greater freedom to decide under the system of preliminary control of mergers, currently limited to the scope of the Antitrust Court. This

draft is expected to create plenty of debate, specially in view of the particular impact of antitrust laws on the development of trade, the freedom of transit and the transaction of goods and services and the discretionary power that the Government would be acquiring.

27. See Part IV *supra*.

28. In this sense, on the surface, 2005 had all the hallmarks of a great year for Argentine business: the country has been out of recession for over three years; production returned to 1998 levels; and the government reported record fiscal and budget surpluses as well as unprecedented GDP growth of almost nine percent per year in the last three years. All this suggests a miraculous recovery since 2002. It is worth noting that, in spite of the economic crisis and the tough rhetoric with which the current government of President Kirchner has addressed bondholders, investors, governments and Argentineans, the government of President Kirchner has managed the economy satisfactorily. Argentina has restructured its public debt, and has settled its debt of approximately US \$10 billion with the IMF, following Brazil's similar initiative. Other positive aspects are an unemployment rate decrease to twelve percent, whereas during the crisis the unemployment level was above twenty percent.

29. The annual average of M&A transactions between 1994 and 1999 was two hundred eighty-one, and total transaction value in 1999 amounted to approximately US \$25 billion. See APERTURA (September 2003) at 23; *id.* (May 1999).

30. According to the information provided by the investment database of the Center of Production Studies (CEP) of the Argentine Ministry of Economics. See EL CRONISTA, 22 December 2005, at 16; EL CRONISTA ABOGADOS CORPORATE, 19 December 2005, at 26.

31. See *Las M&A Que Vienen*, APERTURA (December 2005) at 46.

32. *Id.* Brazilians invested US \$1.2 billion (out of a total of US \$3.5 billion in total value of M&A investors during 2005): for the already mentioned acquisition of Loma Negra by Grupo Camargo Correa, the purchase price was US \$1.025 million, and for Swift, by Friboi, US \$200 million.

33. *Id.*

34. See *Las M&A Que Vienen*, APERTURA (December 2005) at 46.

35. See *Buen año para las fusiones y adquisiciones*, EL CRONISTA, 22 December 2005, at 16.

36. See "*And the money kept rolling in. . .*," BUENOS AIRES HERALD, 19 February 2005.

37. For a review of the current political situation in Argentina and an assessment of President Kirchner's political position on economic and financial issues, see Rohter, *As Argentina's Debt Dwindles, President's Power Steadily Grows*, NEW YORK TIMES, 3 January 2006, at A-1 and A-10.

**Alberto Navarro is a partner in the law firm of G. Breuer in Buenos Aires.**



## COMMENTARY

# Legal Translation Today: Toward a Healthier State of Reality

By Steven M. Kahaner

### I. Introduction

The need to translate legal text from one language into another arises in a number of different scenarios. The more obvious scenarios include bilateral and multi-lateral agreements, international litigation and arbitration, bilingual and multilingual legislative and treaty drafting, and immigration and customs matters, among others. Given our increasingly globalized economy, however, lawyers in almost all practice areas are being called upon to comprehend, analyze and react to foreign-language documents.

Unfortunately, translation services provided to the legal community often do not sufficiently meet the level of accuracy required to ensure that foreign-language documents are correctly understood, thus suggesting the possibility of professional malpractice by the providers of legal translation services and legal malpractice by their clients.<sup>1</sup> As one commentator has pointed out, “[B]ecause law by its very nature is a high-stakes discipline, any distortion may cause parties to believe they have been vested with rights that do not exist in the original foreign language version, or may cause them to believe they do not have an obligation that they indeed do have, potentially costing the party substantial sums of money. In law, the wording is everything, and the changing of one word can completely alter the rights and obligations of a party.”<sup>2</sup>

In defense of the translation industry, it must be admitted that even lawyers are often unable to comprehend highly technical legal language written in their own languages, and judges often experience great difficulty with statutory text in their own jurisdiction. Some scholars argue that legal language is not translatable at all, supporting the Italian proverb *traduttore, traditore* (the translator is a traitor), but such arguments do nothing to obviate a lawyer’s need to comprehend foreign-language documents.

This article will look at the nature of legal translation today and some of the problems involved in producing accurate translations in this field, current barriers to successfully overcoming these problems, and possible solutions to resolve the current situation.

### II. The Nature and Difficulty of Legal Translation

Various skills are required in order to translate successfully a legal document. The first of these skills is fluency (and not merely proficiency) in both the source and target languages. Additionally, the translator needs to be educated in translation theory, which enables the translator to quantify the differences between two languages.

The successful translation of legal text, however, requires more than linguistic skills. This is in part because “legal” language can be viewed as a different language altogether,<sup>3</sup> which is normally learned over the course of many years of study in law school and subsequent training within a law firm. Just as a non-lawyer would have great difficulty translating English legalese into non-legal, “normal” English language, a translator without the requisite training will have similar difficulty correctly transferring the meaning of foreign legalese into the legalese of his or her native language.<sup>4</sup>

One principal difficulty faced by the legal translator is the fact that certain concepts in a source language may not exist in the country where the target language is spoken. For example, the concept of “habeas corpus” does not exist in some cultures or has a different meaning in others. Likewise, the term *procurador* or *licenciado* in Spanish has no functional equivalent in the U.S.

This is why the competent translator must have access to and consult not only monolingual dictionaries but treatises as well. The translator must also be wary of bilingual legal dictionaries, which are often vague and error-prone.

Another complication in legal translation is the high incidence of false cognates between the legal vocabularies of two different languages, particularly between systems with their roots in English law and those with roots in the Romanic-Germanic languages of Europe. For example, the term “arrest” in English is not the same as “*arrestar*” or “*arresto*” in Spanish, nor is “magistrate” the same as “*magistrado*.” The list of false cognates in every language pair is exceedingly long. As

another example, some English words, such as “cram-down,” have even been imported into the language of another country (in this case, Argentina), but with different connotations.

It should also be kept in mind that the same language may be spoken in several different countries, but the meaning of legal language may differ substantially among these countries and regions. The meaning of the English word “libel” is not the same in the United States (which severely restricts its applicability to public figures) as in the United Kingdom, and the meaning of this term changes and evolves with each libel judgment.<sup>5</sup>

A good legal translator also knows that even within the legal field there are completely separate areas of the law which require specific translation techniques: a contractual document has little in common with a will, a judicial decision or a statute.

Finally, the legal translator must understand the intended use of the translation, which has as much bearing on the translator’s approach to translation as the text of the document itself. Terminology, phraseology, syntax, register (tone) and a myriad of other parameters will be affected by the purpose of the translation. For example, is the translation for information purposes only, or binding contract language, or for submission as evidence in court? As source-text documents are often less than clear, the translator must look to the purpose of the translation to determine whether the incomprehensible source text should be glossed over or made equally meaningless in the target language.<sup>6</sup>

All of the foregoing issues require the translator to act as a legal comparativist, familiar with the legal “orders” (a highly particularized local form of discourse that includes a country’s legal system, legal traditions, cultures and history) in which the source-language document originates and the translation is intended.<sup>7</sup> In other words, the translator must deconstruct and decode the source text, and then reconstruct its meaning in the target text. In order to do this, the translator must be part linguist, part legal scholar and part detective, willing and able to search out and define legal concepts expressed in the source language of a document. The translator must also know when a functional equivalent for a word or phrase or a parenthetical explanation is required if an exact translation is impossible.

The scarcity of legal translators who meet the requirements set forth above, along with a number of other barriers to improving the quality of legal translations discussed below, has led to a situation in which law firms and other clients of legal translation providers receive sub-par work product on a regular basis, with the resulting risk that important nuances or technical terms are not properly translated and the

rights of the party relying on the translations are prejudiced.

### III. Barriers to Improving the Quality of Legal Translations

#### A. Clients

There are several reasons why the legal industry has yet to address seriously the issue of inadequately prepared legal translations. First, monolingual lawyers usually do not understand the hardship of translation and cannot distinguish an accurate translation from a flawed one, leading to situations where the parties may use translations of legal text that differ in meaning from the source document. Since the clients do not hold translators accountable for their work, the translators have no incentives to take special precautions to ensure accuracy.<sup>8</sup>

Another factor aggravating the translation industry in this field is indifference toward language and translation issues within the legal community. Although legal translation is one of the principal difficulties of comparative law, the subject is unpopular in the predominantly monolingual American culture. Few in the U.S. legal profession appreciate or discuss the translation process, and U.S. legal practitioners rarely possess bilingual competency themselves or have the resources to order new translations.<sup>9</sup>

In addition, attorneys (especially English-speaking attorneys) tend to draft international documents based on templates designed for the domestic market. Unfortunately, most of these templates contain standard boilerplate terminology containing redundancies (*null and void, covenant and agree, any and all*, etc.), archaic adverbs and prepositional phrases (*hereby, whereby, hereinafter*), Latinisms (*force majeure, prima facie*), and an excessive use of the passive voice. This tendency, coupled with the generally convoluted drafting skills often attributed to lawyers,<sup>10</sup> further increases the complexity of an already difficult task.

Attorneys who do not understand the various steps required to prepare adequately a legal translation also tend to make unreasonable demands in terms of the time given to the translation provider to deliver the final translation. Many agencies and individual translators take on more work than they can handle in an effort to please the client, but are then unable to apply minimum quality control procedures within the given time frame.

Finally, multilingualism is expensive. Apart from the public sector, where translation and interpreting is a multi-billion dollar expense on a worldwide basis,<sup>11</sup> translation and interpreting expenses in individual litigation and arbitration matters can easily reach into the tens or even hundreds of thousands of dollars. In many

cases, this has led clients to seek the lowest cost providers of translation services, regardless of the consequences of such an approach. The resulting “commoditization” of the legal translation industry based on the race to provide the lowest cost per word takes an obvious toll on the ability of translation providers to hire the highly-skilled translators needed to handle this work, as well as their ability to apply adequate quality control procedures to the translation process.

## **B. Translation Providers**

Notwithstanding the shortcomings of their clients, translation industry members themselves admit their profession’s own shortcomings in providing legal translation services.

First, few translators with legal training are involved in the actual translation of documents, and translators who handle legal documents often fail to realize that they need to learn much more than they know about the legal systems of the countries of both the source and target languages. Common errors such as the use of a language dictionary instead of a legal dictionary will result in incompetent translation, but even legal dictionaries seldom provide all of the information needed to produce a competent translation.

Second, the translation industry has been slow to implement quality control mechanisms. Full quality control procedures entail editing of the translation (a word-by-word review and comparison of the source and target documents) by a seasoned editor and a final proofreading by a native-speaker of the target language, as well as the use of common glossaries to ensure that difficult terms are handled consistently by the translators working on any particular project.

Finally, translators and agencies often fail to obtain instructions from their client as to the purpose and intent of the document to be translated. In many cases, a translator cannot correctly translate a document without this information because the main determinant of a translation is its specific function. Even when these instructions or “product specifications” are obtained by an agency from its client, the agency often fails to relay this information to the translator.<sup>12</sup>

## **IV. Suggestions for Improvement**

There are a number of steps that can be taken by translation providers and the lawyers they serve in order to improve the quality of the service that they are providing.

### **A. Translation Providers**

First, legal translators must obtain a significantly higher level of training and experience than is currently the norm before providing work product to their clients. In fact, it has been posited that a legal translator

should study law and train in both the country where the documents were drafted and the country where the translation of those documents is to be used.<sup>13</sup> Due to the high cost of legal training and the generally poor pay of the translation profession, it may be unrealistic to expect that many translators will be willing *or* able to obtain the educational and practical experience of a licensed attorney, but there is no doubt that any translator in this field must spend many years learning the legal concepts and vocabulary of the countries of both the source and the target languages before being considered competent to translate a sophisticated legal document.

Second, translators (and the agencies that hire them) must obtain specifications from the client as to the purpose and role of the document to be translated, and to prepare translations that respond to the needs of the client in each particular situation. For example, where documents are to be used for litigation purposes, care should be taken not to gloss over apparent errors in the original document or apply “Plain English” rules in order to simplify convoluted source text.

Third, better quality assurance procedures must be implemented in order to minimize errors in the translation of documents. This entails the preparation of glossaries and the use of qualified editors and proofreaders in the translation process. There are currently no official standards in the United States governing the translation process or the provider-client relationship.<sup>14</sup>

Finally, translators and agencies must find better ways to reduce the cost of legal translation. This is particularly an issue in the context of litigation, where discovery requests increasingly result in huge stacks of documents written in foreign languages. One method for reducing costs is for a qualified translator to perform “triage” by summarizing and coding documents in order for the attorneys to determine which documents merit translation. Another method is for the translators to perform draft translations not subject to full quality assurance procedures (and thus provided at a lower rate) in order for the client to obtain an understanding of the document and then determine if the translation should be subject to further editing and proofreading.

### **B. Clients**

Without cooperation from legal practitioners, however, improvements will not be possible. Attorneys have an obligation to take steps to ensure that the quality of the service they are receiving meets the needs of their profession.

First, attorneys need to understand that price often (but not always) bears a direct relationship to the quality of the product or service being delivered. As with any other product or service, attorneys should be wary



of hiring the lowest-cost provider without first ascertaining the steps that the provider will be taking to ensure the quality of the translation. Clients would be well-served by verifying the qualifications of the translator(s) working on each project and the quality control procedures used to ensure the accuracy of the translation.

Second, attorneys should budget sufficient time for each project. Most translators are able to translate a maximum of approximately 2,500 words (approximately ten 250-word pages) per day, and an agency will need time to put together a team of qualified translators and editors for higher volumes.

Third, attorneys should be prepared to provide specifications with respect to the documents to be translated. These specifications entail the purpose of the translation, the target audience, a briefing of the issues involved, and relevant background materials, if any. It would also be extremely helpful to provide a contact person to consult regarding ambiguities in the source documents or special terminology that might not be easily found in a dictionary.<sup>15</sup>

Another requirement is for attorneys to improve drafting in general. Typical expressions such as “sell or dispose” and “null and void” are redundant and excessively wordy. Many commentators have expressed the view that such expressions are simply not necessary in the international context and should be replaced by language that is both certain in meaning and easily understandable.<sup>16</sup> This improvement would simplify legal language and thus make it more easily translatable and more likely to be conveyed comprehensibly in the target language.

Finally, attorneys should be better trained in foreign languages and comparative especially if they intend to practice in the international arena. Foreign language study provides sensitivity to the interconnectedness of language to law, culture, history, and politics, and teaches awareness of associations in one language that may not have existing counterparts in another language.<sup>17</sup> An attorney thus educated is also able to verify the quality of the translations he or she is receiving. As Socrates pointed out, “. . . the knowledge of things is not to be derived from names. No; they must be studied and investigated in themselves . . . and no man of sense will . . . so far trust names or the givers of names as to be confident in any knowledge which condemns himself and other existences to an unhealthy state of unreality . . .”<sup>18</sup>

## Endnotes

1. See Kennedy, *Much Ado about Nothing: Problems in the Legal Industry*, 14 TEMPLE INT’L COMP. L.J. 423, 425 (2000).
2. Becerra, *Comparative Law and Legal Translation: A Perspective from Mexico*, 11 PROTEUS (No. 3) 1, 8 (2000).
3. Kennedy, note 1 *supra*, at 426.
4. *Id.* at 427. There are countless terms in “legal” English that can be a trap for the unwary translator. For example, a translator might reasonably assume that “judicial notice” means “notice given by a judge.” As most lawyers know, however, this term really refers to the ability of a judge to “take notice” of certain facts under the Federal Rules of Evidence.
5. Joseph, *Indeterminacy, Translation and the Law*, in TRANSLATION AND THE LAW, American Translators Association Scholarly Monograph Series, vol. VIII, pp. 13, 29 (1995).
6. Mikkelsen, *Awareness of the Language of the Law and Preservation of Register in the Training of Legal Translators and Interpreters*, online article available at <http://www.acebo.com/papers/legland.htm>.
7. Kennedy, note 1 *supra*, at 425.
8. *Id.* at 434-35. The fact that there are no reported decisions in the United States regarding the negligent provisions of translation services, or even anecdotal reports of claims by law firms against translators, supports this conclusion. *Id.*
9. *Id.*
10. See Rawlson, *Just Fix the English*, CLARITY – JOURNAL OF THE INTERNATIONAL ASSOCIATION PROMOTING PLAIN ENGLISH, No. 53, at 25 (May 2005): “Lawyers have two common failings. One is that they do not write well and the other is that they think they do.” *Id.*, at 26, citing Felsenfeld, *The Plain English Movement in the United States*, 6 CANADIAN BUS. L.J. 408 (1981-82).
11. EU institutions alone spend 800 million euros a year translating documents. Jenkinson, *Europe’s 200 Languages, Costly to EU, are Hailed by Brussels*, Bloomberg News, 30 September 2005, available at <http://www.bloomberg.com/apps/news?pid=10000085&sid=azt7Uw15xhBw#>.
12. Kennedy, note 1 *supra*, at 429.
13. *Id.*; Becerra, note 2 *supra*, at 10.
14. Standards for the translation industry are currently being developed by ASTM International ([www.astm.org](http://www.astm.org)) and the European Committee for Standardization (<http://www.cenorm.be/cenorm/index.htm>). ASTM has already developed an interpreting standard.
15. Becker, *Finding the Right Foreign Language Professional*, LEGAL MANAGEMENT 32, 40 (January/February 1996).
16. See publications by Clarity—an international association promoting plain legal language available at [www.clarity-international.net](http://www.clarity-international.net).
17. Kennedy, note 1 *supra*, at 443.
18. Plato, CRATYLUS (Jowett translation).

**Mr. Kahaner is the Executive Director of Juriscribe.**

**©Steven M. Kahaner 2005. All rights reserved.**

# Practical Implications of the Diversity of Languages and Legal Cultures in International Practice

By Frank G. Helman

## I. Introduction: The Importance of Properly Conveying Context in Legal Translation

Translation is not only about getting the right word—which can be hard enough—but also about conveying the cultural context, which can often give a meaning to a term that is not apparent on its face. This can be a fascinating or frustrating intellectual exercise (or both). But in the legal realm, it can also have practical consequences, and that’s what I’m going to talk about. The examples will reflect my field, which is inheritance law, and mismatches between common law and civil law concepts, but similar tales could be told in any area of the law.

In the interest of brevity, I have simplified (possibly oversimplified) some of the concepts presented. And while these are actual cases, I have changed the names to respect my clients’ privacy.

## II. Inheritance Law: Mismatches between Common Law and Civil Law Concepts

Let’s start with wills. A will in the United States, as in many common law jurisdictions, must generally be signed at the end by the testator and two witnesses. Notarial wills, frequently found in civil law countries, may require only the signature of the testator and the notary. The distinction is often of little consequence, and the term “will” is used—without further qualification—for both types of instruments. But they are not necessarily equivalent.

Take the case of Mr. Brown, who owned real property near Atlanta, Georgia. He had made a notarial will in a civil law jurisdiction, which does not require witnesses to such a will. Georgia, however, recognizes only wills that meet its own formal requirements and, since Mr. Brown’s notarial will did not have the requisite number of witnesses, it was not valid in Georgia. In the absence of a valid will, intestate succession would determine who inherited the Georgia property, which was not at all what Mr. Brown had intended.

“Estate,” “executor,” “heir” and “legatee” are other terms that are often used as though they had the same meaning in the common law as in the civil law, when the concepts in fact can differ significantly.

“Estate,” as understood in the United States, is a legal entity (and a taxpayer), to which the decedent’s property passes pending final settlement. It comes into existence upon death and continues until final distribution of all the estate assets. It can be likened to a limited liability company in liquidation, and like such a company, it has a managing director, who is called the executor. Under the civil law, however, title to the decedent’s property vests in the heirs at the time of death, so there is no separate legal entity as we know it: “estate” refers only to the assets of the decedent at the time of death.

And since there is no estate in our sense, the role of the executor is different as well. The executor of a decedent’s estate in the United States steps into the shoes of the decedent, taking possession and control of his or her property, and legal title as well. The civil law executor does not have the comprehensive authority of one in the United States, but only the powers granted in the will. Nor does the civil law executor become the legal owner of the decedent’s property, since title is in the heirs.

In the United States, bequests and other obligations of the estate, such as taxes, debts of the decedent, and costs of administration, are satisfied by the executor before distribution to the residuary legatees. Civil law legacies do not come out of the estate—since, as we have seen, there is no such entity—but rather constitute a claim against the heirs, since they are the ones who have the property.

The interrelations among these concepts are illustrated by the estate of Mr. Wallace. He had been an art dealer, and his estate included a substantial inventory of works of art. His only other significant asset—by far the greater one—was a securities portfolio. Although he was an American citizen, Mr. Wallace had grown up in a civil law country, so when he sat down to write his will (he didn’t want to waste money on lawyers, so he did it himself), he wrote in English but was thinking in civil law concepts.

He bequeathed the securities portfolio to his grandsons, whom he also appointed as his “heirs.” However, one of the boys had fallen under the influence of a guru, so Mr. Wallace directed that this grandson’s share of the inheritance be administered by his brothers. He

gave the artwork, as well as a “usufruct” in a portion of the remaining estate, to his girlfriend, who lived in Germany (thus triggering German inheritance taxes). Then he directed that the estate and inheritance taxes be paid from the residuary estate. But since he had disposed of substantially all his property by specific bequest, there was no residuary estate.

Upon his death, we had to translate these civil law concepts into structures that are permissible under New York law. We decided that the administration of the one grandson’s share by his brothers could be accomplished by setting up a trust for his benefit with the brothers as trustees. Similarly, the effect of a “usufruct” for the girlfriend could be attained by a trust as well. We then had to convince the surrogate’s court that this was the most appropriate way to interpret the will.

The allocation of the death taxes involved a thicket of interrelated credits and computations which would fill an entire chapter by itself. The whole thing proved to be a monumental task that took half a dozen lawyers over five years to sort out. By the time it was all over,

nearly \$300,000 had gone for legal fees. His heirs wished that he had invested a few thousand dollars while he was alive to have an attorney who understood both his intentions and the relevant legal concepts draft a proper will. It’s a lot easier—and a lot cheaper—to do something right in the first place than to try to correct errors such as Mr. Wallace’s after the fact.

### III. Summary

So, as Mr. Brown and Mr. Wallace illustrate, it’s important not only to use the right words, but also to take the cultural context into account. Failure to recognize and understand the differences between concepts across national borders can lead to serious problems for attorneys serving clients with international transactions—and to even more serious problems for their clients.

**Mr. Helman is a practicing attorney in New York City and Boothbay Harbor, Maine, and over the years has represented many European clients.**

## NYSBA’s CLE Online

# Bringing CLE to you... *anywhere, anytime.*

NYSBA is proud to present the most flexible, “on demand” CLE solution you could ask for.

With **CLE Online** (also available as **CLE on CD**), you can now get the valuable professional learning you’re after  
*...on your own terms.*

- Get the best NY-specific content from the state’s **#1 CLE provider.**
- Take “Cyber Portable” courses from your laptop, at home or at work, via the Internet or on CD.
- Stay at the head of your profession with outstanding CLE instruction and materials.
- Everything you need to obtain full MCLE credit is included **online or on CD!**



**Come click for CLE credit at:**

**[www.nysbaCLEonline.com](http://www.nysbaCLEonline.com)**

or to purchase CDs  
call 800-582-2452





## INTERNATIONAL LAW & PRACTICE SECTION OFFICERS—2006

**Chair** .....John F. Zulack, Flemming Zulack Williamson Zauderer, LLP  
One Liberty Plaza, 35th Floor, New York, NY 10006-1404

**Chair Elect** .....Oliver J. Armas, Thacher Proffitt & Wood LLP  
Two World Financial Center, New York, NY 10281

### Vice-Chairs

<p>Mark H. Alcott, Paul, Weiss, et al. 1285 Avenue of the Americas, New York, NY 10019</p> <p>Jonathan P. Armstrong, Eversheds, LLP 85 Queen Victoria Street, London EC4V 4JL UK</p> <p>John E. Blyth 1115 Midtown Tower, Rochester, NY 14604</p> <p>Prof. Sydney M. Cone, III, New York Law School 57 Worth Street, New York, NY 10013</p> <p>David W. Detjen, Alston &amp; Bird, LLP 90 Park Avenue, 14th Floor, New York, NY 10016-1302</p> <p>Gerald J. Ferguson, Baker &amp; Hostetler LLP 666 Fifth Avenue, New York, NY 10103</p> <p>Kathryn Bryk Friedman 51 Lancaster Avenue, Buffalo, NY 14222</p> <p>Joyce M. Hansen, Federal Reserve Bank of NY 33 Liberty Street, 7th Floor, New York, NY 10045</p>	<p>Allen E. Kaye, Law Offices of Allen E. Kaye, PC 111 Broadway, Suite 1304, New York, NY 10006</p> <p>Jennifer K. King, Flemming Zulack et al. One Liberty Plaza, New York, NY 10006</p> <p>Steven C. Krane, Proskauer Rose LLP 1585 Broadway, Room 1778, New York, NY 10036</p> <p>A. Thomas Levin, Meyer Suozzi English &amp; Klein, PC 1505 Kellum Place, PO Box 803, Mineola, NY 10051</p> <p>Michael M. Maney, Sullivan &amp; Cromwell 125 Broad Street, New York, NY 10004-2498</p> <p>Eduardo Ramos-Gomez, Duane Morris LLP 380 Lexington Avenue, 48th Floor, New York, NY 10168</p> <p>Saul L. Sherman PO Box 820, 221 Mecox Road, Water Mill, NY 11976</p> <p>Lorraine Power Tharp, Whiteman Osterman &amp; Hanna LLP One Commerce Plaza, Albany, NY 12260</p>
--	--

**Executive Vice-Chair** .....Marco A. Blanco, Curtis, Mallet-Prevost, Colt & Mosle  
101 Park Avenue, New York, NY 10178

**Secretary** .....Michael W. Galligan, Phillips Nizer LLP  
666 Fifth Avenue, New York, NY 10103

**Assistant Secretary** .....Nava Bat-Avraham  
Greenwich, CT 06831

**Treasurer** .....Lawrence E. Shoenthal, Weiser LLP  
135 West 50th Street, 12th Floor, New York, NY 10020

**Immediate Past Chair** .....Robert J. Leo, Meeks & Sheppard  
330 Madison Avenue, 39th Floor, New York, NY 10017

**Delegates to the NYSBA House of Delegates** .....James P. Duffy, III, Berg & Duffy, LLP  
3000 Marcus Avenue, Suite 1W02, Lake Success, NY 11042

Paul M. Frank, Alston & Bird LLP  
90 Park Avenue, 15th Floor, New York, NY 10016

Kenneth A. Schultz, Satterlee Stephens Burke & Burke  
230 Park Avenue, New York, NY 10169

**Alternate Delegate** .....John Hanna, Jr., Whiteman Osterman & Hanna LLP  
One Commerce Plaza, Albany, NY 12260

## INTERNATIONAL LAW & PRACTICE SECTION COMMITTEES

<p><b>Asian Pacific Law</b> .....Lawrence A. Darby, III (212) 836-8235 Junji Masuda (212) 258-3333</p> <p><b>Awards</b> .....Jonathan I. Blackman (212) 225-2000 Michael M. Maney (212) 558-3800 Lauren D. Rachlin (716) 848-1460 Saul L. Sherman (631) 537-5841</p>	<p><b>Central and Eastern European and Central Asian Law</b> .....Serhiy Hoshovskyy (212) 370-0447</p> <p><b>Corporate Counsel</b> .....Carole L. Basri (212) 982-8243 Michael J. Pisani (516) 849-0508</p> <p><b>Customs and International Trade</b> .....Claire R. Kelly (718) 780-0398 Stuart M. Rosen (212) 310-8000</p>
--	--

<b>Immigration and Nationality</b> .....	Jan H. Brown (212) 397-2800 Nina Juncewicz (716) 884-2558	<b>International Trade Compliance</b> .....	Timothy M. Ward (212) 899-5560
<b>Inter-American Law Including Free Trade in the Americas</b> .....	Carlos E. Alfaro (212) 698-1147	<b>International Transportation</b> .....	William H. Hagendorn (914) 337-5861 Alfred E. Yudes, Jr. (212) 922-2211
<b>International Banking, Securities and Financial Transactions</b> .....	Joyce M. Hansen (212) 720-5024 Eberhard H. Rohm (212) 484-3900	<b>Multinational Reorganizations and Insolvencies</b> .....	Robert W. Dremluk (212) 696-8861
<b>International Dispute Resolution</b> .....	Peter Hyde Woodin (212) 239-9106	<b>Publications /Editorial Board</b> .....	Oliver J. Armas (212) 912-7627 Prof. Charles Biblowit (718) 990-6760 David W. Detjen (212) 210-9416 Lester Nelson (212) 983-1950 Richard A. Scott (212) 218-2995
<b>International Employment Law</b> .....	Aaron J. Schindel (212) 969-3090	<b>Public International and Comparative Law / Arms Control and National Security</b> .....	Prof. Charles Biblowit (718) 990-6760 Hon. Edward R. Finch, Jr. (212) 327-0493
<b>International Entertainment</b> .....	Gordon W. Esau (604) 443-7105	<b>Real Estate</b> .....	Thomas Joergens (212) 284-4975
<b>International Environmental Law</b> .....	John Hanna, Jr. (518) 487-7600 Andrew D. Otis (212) 696-6000 Mark F. Rosenberg (212) 558-3647	<b>Seasonal Meeting</b> .....	Lawrence A. Darby, III (212) 836-8235 Joel B. Harris (212) 912-7785 Xingxi Fu-Tomlinson 86-21-5298-4268
<b>International Estate and Trust Law</b> .....	Michael W. Galligan (212) 841-0572	<b>South Asian Law</b> .....	Babar Sattar (212) 859-8776
<b>International Human Rights</b> .....	Arthur L. Galub (212) 595-4598 Rachel L. Kaylie (212) 406-7387	<b>Tax Aspects of International Trade and Investment</b> .....	Javier Asensio (212) 784-8800 Marco A. Blanco (212) 696-6128
<b>International Intellectual Property Protection</b> .....	Gerald J. Ferguson (212) 589-4238 L. Donald Prutzman (212) 355-4000	<b>U.N. and Other International Organizations</b> .....	Jeffrey C. Chancas (212) 431-1300 Edward C. Mattes, Jr. (212) 308-1600
<b>International Investment</b> .....	Aureliano Gonzalez-Baz 52 (55) 5279-3601 Lawrence E. Shoenthal (212) 375-6847	<b>U.S.-Canada Law</b> .....	David M. Doubilet (416) 865-4368
<b>International Litigation</b> .....	Thomas N. Pieper (212) 912-8248	<b>Western European Law</b> .....	Stefano Crosio (212) 424-9174 Michael L. Sher (212) 421-1311
<b>International Matrimonial Law</b> .....	Rita Wasserstein Warner (212) 593-8000	<b>Women's Interest Networking Group</b> .....	Jennifer K. King (212) 412-9537 Meryl P. Sherwood (212) 644-2343
<b>International Privacy Law</b> .....	Nava Bat-Avraham (212) 217-0088 Laura Becking (212) 773-6021 Andre R. Jaglom (212) 508-6740		
<b>International Sales and Related Commercial Transactions</b> .....	John P. McMahon (803) 980-1800		

## INTERNATIONAL DIVISION OFFICERS—CHAPTER CHAIRS

**Jonathan P. Armstrong** (Co-chair)  
Eversheds LLP  
Senator House  
85 Queen Victoria Street  
London EC4V 4JL United Kingdom  
44-0-113-200-4658  
jonathanarmstrong@eversheds.com

**Gerald J. Ferguson** (Co-chair)  
Baker & Hostetler LLP  
666 Fifth Avenue  
New York, NY 10103  
(212) 589-4238  
gferguson@bakerlaw.com

**Eduardo Ramos-Gomez** (Co-chair)  
Duane Morris LLP  
380 Lexington Avenue, 48th Floor  
New York, NY 10168  
(212) 692-1074  
eramos-gomez@duanemorris.com

### Amsterdam

Steven R. Shuit  
Allen & Overy  
Postbus 75440  
Amsterdam 1070 AK Netherlands

### Athens

Niovi P. Christopoulou  
Arnold & Porter LLP  
399 Park Avenue  
New York, N.Y. 10022-4690  
212-715-1044

### Barcelona

Jaime Malet  
Malet, Abogados  
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

### Berlin

Jens Eggenberger  
Freshfields Bruckhaus Deringer  
Potsdamer Platz 1  
Berlin 10785, Germany

### Brussels

George L. Bustin  
Cleary Gottlieb et al.  
57 Rue De La Loi  
Brussels 1040, Belgium  
(322) 287-2000

Paul Van Hooghten  
Linklaters De Bandt  
Brederodestraat, 13  
Brussels 1000 Belgium  
322-501-9588

### Budapest

Andre H. Friedman  
Nagy & Trocsanyi, LLP  
599 Lexington Ave., Suite 2328  
New York, NY 10022  
(212) 459-7070

### Buenos Aires

Juan Martin Arocena  
Rattagan Macchiavello Arocena &  
Peña, Robirosa Avenida De Mayo 701,  
Piso 18  
Buenos Aires, Argentina  
54-11-4010-5000

Guillermo Malm Green  
Brons y Salas Abogados  
Maipu 1210, 5th Floor  
C1006ACT Buenos Aires, Argentina  
54-11-4891-2707

Alberto Navarro  
G. Breuer  
25 De Mayo 460  
C1002ABJ Buenos Aires, Argentina  
54-11-4313-8100

### Cyprus

Christodoulos G. Pelaghias  
Law Offices of Chr. G. Pelaghias  
27 Gregory Afxentiou Avenue  
PO Box 40672  
Larnaca, 6306, Cyprus  
(357) 2465-4900

### Dublin

Eugene P. Fanning  
E P Fanning & Co.  
71 Ailesbury Rd., Ballsbridge  
Dublin 4, Ireland  
(353) 1219-5935

### Frankfurt

Rudolf Colle  
Dewey Ballantine LLP  
Reuterweg 16, D-60323  
Frankfurt Am Main, Germany  
49-69-636-930

### Geneva

Nicholas Pierard  
Borel & Barbey  
2 Rue De Jargonnant  
Case Postale 6045  
Geneva 1211 6, Switzerland  
4122-736-1136

### Israel

Mitchell C. Shelowitz  
Nixon Peabody, LLP  
437 Madison Avenue  
New York, NY 10022-7001  
(212) 940-3000

Eric S. Sherby  
Sherby & Co. Advs.  
South Africa Building  
12 Menahem Begin St.  
Ramat Gan 52521, Israel  
972-3-753-8668

### Istanbul

Mehmet Komurcu  
Birsell Law Offices  
Inonu Caddesi No. 53  
Ongan Apartmani K;4 Gumussuyu  
Istanbul 34439, Turkey  
90-212-245-5015

### La Paz

Ramiro Guevara  
Guevara & Gutierrez S.C.  
Calle 15 Calacoto  
Torre Ketal, Piso 4 / Oficina 2  
La Paz, Bolivia  
59-12-277-0808

### Lima

Guillermo Ferrero  
Estudio Ferrero Abogados  
Av. Victor Andrés Belaunde 395  
San Isidro, Lima 27, Peru  
511-442-1320  
Jose Antonio Olaechea  
Estudio Olaechea  
Bernardo Montegudo 201  
San Isidro, Lima 27, Peru  
511-264-4040

Jose Miguel Morales  
Estudio Aurelio Garcia Sayan  
Av. El Rosario  
San Isidro, Lima 27  
511-440-7341

### Lisbon

Pedro Pais De Almeida  
PACSA Law Firm  
VAT PT 503 655 511  
Av. da Liberdade 144 / 7 Dt  
1250-146 Lisbon, Portugal  
351-21-324-1600

### London

Jonathan Armstrong  
Eversheds, LLP  
Senator House  
85 Queen Victoria Street  
London EC4V 4JL, United Kingdom  
44-113-200-4658



Randal J C Barker  
Genworth Financial, 80 Strand  
London WC2R OGR, United Kingdom  
44-207-599-1514

Anne E. Moore-Williams  
310 The Whitehouse, 9 Belvedere Rd.  
London SE1 8YS, United Kingdom  
44-7802-756-776

#### **Lugano**

Lucio Velo  
Velo & Associati  
Piazza Riforma #5  
6900 Lugano 1, Switzerland  
0041-91-924-0451

#### **Luxembourg**

Alex Schmitt  
Bonn Schmitt & Steichen  
44 Rue De La Vallee  
L-2661 Luxembourg  
352-45-5858

#### **Madrid**

Calvin A. Hamilton  
Monereo, Meyer & Marinel-lo  
C/ Bárbara De Braganza 11, 2º  
Madrid 28004, Spain  
(3491) 319-9686

Clifford J. Hendel  
Araoz & Rueda  
Castellana 164  
Madrid 28046, Spain  
(3491) 319-0233

#### **Manila**

Efren L. Cordero  
No. 44 A. Periquet Street  
Las Pinas City  
Metro Manila, Philippines  
(632) 631-1177

#### **Mexico City**

Aureliano Gonzalez-Baz  
Bryan Gonzalez et al.  
Seneca 425 Polanco  
Mexico D.F., 11560, Mexico  
52 (55) 5279-3601

#### **Milan**

Maurizio Codurri  
Frau & Partners SLA  
Via C. Poerio 15  
Milano 20129, Italy  
39-02-764-271

Alessandro Giuliani  
Gianni Origoni & Partners  
Piza Belgioioso 2  
20122 Milan, Italy  
39-027-63741

#### **Montevideo**

Nicolas Jorge Herrera  
Guyer and Regules  
Plaza Independencia 811  
11100 Montevideo, Uruguay  
5982-902-1515

#### **Moscow**

Mads R. Loewe  
DLA Piper Rudnick Gray Cary  
Ulitsa Pudovkina, Dom 3, Kv. 46  
Moscow 119285, Russia  
7095-790-7558

William R. Spiegelberger  
White & Case LLP  
1155 Avenue of the Americas  
New York, NY 10036

#### **Panama**

Alvaro J. Aguilar  
PO Box 55-1110, Paitilla  
Panama City 99999, Panama  
(507) 263-5333

Juan Francisco Pardini  
Pardini & Associates  
PO Box 9654, Zone 4  
Panama City, Panama  
(507) 223-7222

#### **Paris**

Yvon Dreano  
Jeantet Associés  
87 Avenue Klebér  
75116 Paris, France  
(331) 45-05-80-15

Douglas Glucroft  
Nixon Peabody LLP  
437 Madison Avenue  
New York, NY 10022-7001  
(212) 940-3716

#### **Quito**

Evelyn L. Sanchez  
Corral-Sanchez Abogados S.A.  
Republica De El Salvador #880, 8 Avo. Piso  
Quito, Ecuador  
5932-2469-300

#### **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

#### **San Jose**

Hernan Pacheco  
Pacheco Coto, Attorneys at Law  
PO Box 6610  
San Jose 01000, Costa Rica  
(506) 258-1619

#### **Council of Licensed Legal Consultants**

Ramon Maria Segura

#### **São Paulo**

Pablo M. Bentes  
Machado, Meyer, Sendacz e Opice  
Rua Da Consolação, 247, 3º Andar  
São Paulo, Brazil 01301-903  
55-11-3150-7623

#### **Stockholm**

Carl-Olof Erik Bouveng  
Advokatfirman Lindahl HB  
PO 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 BC V6C 2Z7, Canada  
(604) 643-2949

#### **Vienna**

Christoph Kerres  
Baker McKenzie-Kerres & Diwok  
Schubertring 2  
A-1010, Vienna, Austria  
(431) 516-60-100

#### **Zurich**

Erich Peter Ruegg  
Schumacher Baur Hurlimann  
Oberstadtstrasse 7  
5400 Baden, Switzerland  
41-56-200-0707

Martin E. Wiebecke  
Anwaltsburo Wiebecke  
Kohlrainstrasse 10 Kusnacht  
Zurich CH-8700, Switzerland  
41-01-914-2000

#### **Western New York**

Christine A. Bonaguide  
Hodgson Russ LLP  
One M&T Plaza, Suite 2000  
Buffalo, NY 14203  
(716) 848-1325

Kathryn Bryk Friedman  
51 Lancaster Avenue  
Buffalo, NY 14222

#### **Florida**

Leslie N. Reizes  
Reizes Law Firm Chartered  
1177 George Bush Blvd., Suite 308  
Delray Beach, FL 33483  
(561) 276-2600

Shanghai | 上海



## SAVE THE DATE

Fall 2006 Meeting

October 17-21, 2006

"CHINA: Engine of Growth  
for the 21<sup>st</sup> Century"

**JW Marriott Hotel  
Shanghai, China**



International Law  
and Practice Section

For More Information  
Please Contact:

**John F. Zulack, Section Chair**

Flemming Zulack Williamson  
Zauderer LLP, New York City

**Lawrence A. Darby III, Program Chair**

Kaye Scholer LLP, New York City

**Joel B. Harris, Program Co-Chair**

Thacher Proffitt & Wood LLP, New York City

**Yingxi Fu-Tomlinson, Program Co-Chair**

Kaye Scholer LLP, Shanghai



Shanghai | 上海

*Mark Your  
Calendars  
Now . . .  
and  
Join Us In  
Shanghai  
in October 2006*

*As we explore  
the legal aspects  
of China's  
emergence as an  
engine of growth for  
the 21<sup>st</sup> Century*



International Law  
and Practice Section

# INTERNATIONAL LAW PRACTICUM

## Editorial Board

**Editor in Chief**  
David W. Detjen

**Executive Editors**  
Torsten Kracht  
David W. Detjen

**Articles Editor**  
Thomas Backen

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.

© 2006 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