NYSBA WINTER 2012 | Vol. 30 | No. 3

Inside

A publication of the Corporate Counsel Section
of the New York State Bar Association

Message from the Chair

Thanks to Alliance Bernstein for hosting our 7th Annual Kenneth G. Standard Diversity Internship Reception on August 14, 2012. The thanks cannot be expressed in words for the support provided by Laurene E. Cranch, general counsel of Alliance Bernstein, and Elizabeth "Liz" Agge, his assistant, in putting on the program. There were almost 100 people who attended the reception and almost everyone who attended played a part in getting the nine interns through the program. Just ask Andrew Mannarino, my co-chair on the Kenneth G. Standard Diversity Internship Program Committee, who was this year's MC for the event, and did an unbelievable job. There are too many to thank here, but we appreciate Kaplan's support this year. Kaplan awarded one student, randomly drawn, a free bar preparation course.

It is important we nurture our interns and making sure they pass the bar is just one step in the process of developing the future of our profession. Our mentorship program for past interns will be launched by the time you read this. Our past interns started to mentor our current interns. If you want to get involved in any of the activities above please reach out to me or any one on our executive committee. We will be gearing up for next year soon.

Inside

Editors: Janice Handler and Allison B. Tomlinson

We continue to press forward on allowing in-house counsel, who have not been admitted to the New York bar but are registered in New York, to provide pro bono services while working for their employers. Our Technology and New Media Committee keeps improving on providing timely content. However, we need your help, so please contact us to volunteer and get involved.

David Rothenberg

Inside Inside

We hope that you enjoy this end of the year issue of *Inside*. We wanted the focus to be on dispute resolution around the world—what's new and exciting, what do you need to think about as corporate counsel at a global company negotiating these provisions in your contracts, and what really happens when you are handling a dispute in a forum where you've never been before.

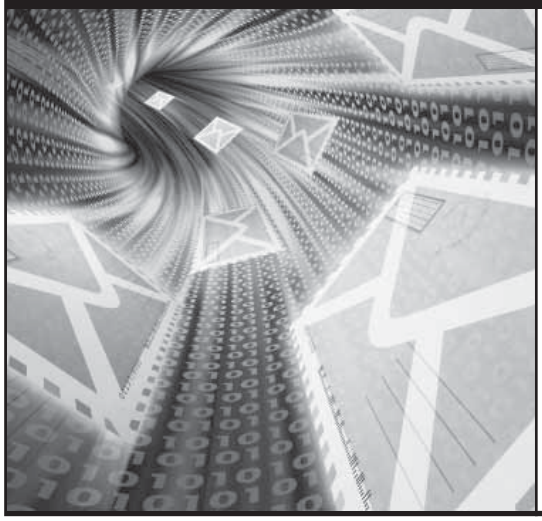
We also included a recap from our Diversity Intern Reception this past summer, and a couple of special tidbits on hot topics around the globe, including computing in the cloud.

Enjoy! And have a wonderful holiday season!

Allison

Allison B. Tomlinson is Regional Counsel at Gensler, a global architecture and design firm based in the New York office. Her region includes the northeastern U.S., Ontario and Latin America. She is co-editor of *Inside* and a member of the executive committee of the Corporate Counsel and International Sections.

Request for Articles



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Articles should be submittted in electronic document format (pdfs are NOT acceptable), and include biographical information.

International Commercial Disputes: To Arbitrate or to Litigate, That Is the Question

By Oliver Armas and Thomas Pieper

Parties entering into a cross-border contract often wonder whether they should agree to litigate or to arbitrate potential disputes. More specifically, they ask which method is more effective, faster, and less expensive. There is no one-size-fits-all answer, and several factors should be taken into account. Some considerations, including practical tips, are set forth below.

Time

Given their procedural characteristics, the time line of a typical international arbitration is not the same as an average litigation in the United States. Some key differences:

- There is not much "discovery" in international arbitration. There may be document production, but rarely depositions. The scope of the document disclosures largely depends on the agreement of the parties and the legal background of the arbitrator. If the arbitrator comes from a common law jurisdiction, the scope may be broader than if the arbitrator is from a civil law jurisdiction. But either way, the exchange of documents in most international arbitrations is very limited, with the requesting party having the initial burden to show that the documents sought are "relevant and material." In U.S. federal court litigation, the information sought in discovery "need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence." Fed. R. Civ. P. 26(b)(1). Broad-ranging requests for "any and all" documents are commonplace in litigation, while generally not acceptable in international arbitration. Additionally, because depositions are rare in international arbitrations, the usual practice is for testifying witnesses to prepare written declarations which usually serve as direct testimony at the arbitration hearing.
- In U.S. litigation, motion practice is commonplace, while in international arbitration it is still the exception. However, some motions, especially those which dispose of substantive claims, are becoming more popular in arbitration. The rules of some arbitral institutions specifically provide for dispositive motions, and courts have found that arbitrators have implicit authority to rule on summary adjudication-type motions.
- The pleading requirements of U.S. courts and international arbitral tribunals differ. The U.S. Supreme Court has heightened the pleading standards in federal court litigation in its *Iqbal* and *Twombly* decisions. Under the Federal Rules of Civil Procedure, a complaint must contain a "short and plain statement of the claim showing that the pleader is entitled to relief." Applying a two-pronged approach, the U.S. Supreme Court interprets this to mean that the party is required to make factual allegations that, if accepted as true, "state a claim to relief that is plausible on its face." A claim has facial plausibility if the pleaded facts allow the court to draw the reasonable inference that the defendant is liable for the alleged misconduct. Conversely, pleadings that are no more than conclusions are not entitled to the assumption of truth. Legal conclusions may provide the framework of a complaint, but they must be supported by factual allegations. In other words, if there are well-pleaded factual allegations, a court will assume their veracity and determine whether they plausibly entitle the plaintiff to the relief sought. If the plaintiff does not meet this heightened standard, its complaint will be dismissed. In international arbitration, such strict pleading standards do not apply, making it easier for claimants to bring meritless claims and force respondents to spend time (and resources) in defense.
- With the stated goal of providing quick and final resolution to disputes, one of the hallmarks of arbitration is the absence of appeals and a stark limitation of judicial review of arbitration awards. While the parties are, in theory, free to agree on appellate review in arbitrations, it is very rarely done. As such, the only judicial review of an arbitral award is at the enforcement stage. But an international arbitration award can only be set aside if there are fundamental violations such as if it was procured by "corruption," "fraud" or "undue means" and where the arbitrators were "guilty of misconduct" or "exceeded their powers." 9 U.S.C. § 10(a)(1)-(4). The U.S. Supreme Court has held that the parties cannot expand this limited scope of review by agreement. A proceeding to vacate an arbitration award is not a de novo review, and a court will not overturn an award if arbitrators "got it wrong" on the merits. A court may vacate an arbitration award if the arbitrators "manifestly disregarded" the applicable law, but the manifest disregard standard is, by design, exceedingly difficult to satisfy. The complaining party must basically prove that the arbitrators knew the applicable law, but purposefully decided not to apply it. U.S. courts

increasingly sanction parties (and counsel) for filing frivolous challenges against arbitral awards.

It follows from the foregoing that arbitration tends to be faster than court litigation. An average arbitration takes somewhere between 18 and 24 months, whereas a comparable court litigation may continue for several years, especially if appeals are filed. If, on the other hand, a party is most likely to win on a motion for summary judgment since the other side does not have any real defenses (and is simply unable to perform), court litigation may be the quicker way to obtain a final judgment.

Costs

Arbitration and litigation also differ in terms of costs. Since the average arbitration moves quicker (as set forth above), it typically requires less attorney's fees.

Having said that, not only do the arbitrators have to be identified, vetted, and appointed (all of which takes expensive attorney time), arbitrators, unlike judges, are paid by the parties. In administered arbitrations, the arbitral institution also charges fees. While such costs may be recoverable by the winning party (depending on the rules of the arbitral institution and the arbitration clause), the parties will have to pay advance payments on these costs from the outset of the arbitration. Different institutions have different models. Under some arbitration rules, the arbitrators charge by the hour, whereas in others, the panel gets compensated based on the amount at stake.

To put things in perspective, let's assume a party wants to bring a claim for $50 million. Under the rules of the International Chamber of Commerce (the "ICC"), the party has to pay a non-refundable filing fee of $3,000 when it submits its request for arbitration. The ICC will also request an advance to cover the costs of the arbitration. For a $50 million dispute, the advance on costs exceeds $600,000. This amount is split between the parties, which means the claimant has to pay more than $300,000 to commence the case. (In addition, if the respondent refuses to pay, the claimant has to bear the entire advance if it wants the arbitration to move forward.) To bring the same $50 million complaint in a U.S. federal court only requires a $350 filing fee.

If the amount at stake is relatively low, it may make little sense to pay expensive arbitrators. At the very least, parties may want to provide in their arbitration clause that if all disclosed claims and counterclaims do not reach a certain threshold, the case will be heard by a sole arbitrator instead of a panel of three.

Enforceability of the Final Decision

A decision is useful to the winning party only if it is enforceable. Court judgments and arbitral awards rendered in a U.S. state are generally enforceable in all sister states. If enforcement will have to be sought abroad, however, things are different. Currently, the United States has no treaty regarding the mutual recognition and enforcement of court judgments with any country in the world. International enforcement of court judgments is thus mostly dependant on comity, which makes it sometimes extremely difficult, if not impossible, to enforce a U.S. judgment abroad.

An international arbitration award, by contrast, will be enforceable almost anywhere in the world. The United States has joined the most important international treaties in that area, namely the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and the Inter-American Convention on International Commercial Arbitration (the Panama Convention). Under these treaties, an arbitral award issued anywhere can generally be enforced in a contracting state (some contracting states have elected to enforce only awards from other contracting states), subject only to certain, limited defenses and without a *de novo* review.

Confidentiality

U.S. courts publish their dockets, and their records can even be accessed online. Court hearings are usually public as well, which means that anyone can attend, not just the litigants. To exclude the public from a hearing or to file submissions under seal requires a protective order from the court. The requesting party must show "good cause" to justify sealing, and case law interpreting this standard has generally mandated a demonstration of "compelling circumstances."

Arbitral proceedings make it much easier to keep things confidential. Most arbitration rules provide for privacy, i.e., the arbitral institution. The arbitrators are not allowed to disseminate any documents or information relating to the arbitration, and the hearings are private as they are usually held at a conference room at a hotel, a law firm, or an arbitral organization. Complete confidentiality (also prohibiting the parties from passing on any information) is easy to achieve by complementing the arbitration clause with a confidentiality provision. Unless there is a court proceeding to enforce and/or challenge an arbitral award, or one of the parties has to disclose certain aspects of the award in order to comply with reporting obligations, the general public would not be aware of the existence, let alone the outcome, of the arbitration. As such, where confidentiality is of great concern to a party, arbitration has certain advantages.

Expertise

In court litigation, the parties have to present their respective cases to a judge or jury randomly assigned to them. While the judges of the federal bench in the U.S. and of specialized commercial courts of some States (such as

the Commercial Division of the Supreme Court of New York State) enjoy an excellent reputation, they may lack the expertise to easily evaluate highly technical issues. And juries almost always lack relevant expertise. International arbitration, on the other hand, permits parties to select arbitrators with expertise in the subject matter in dispute. Usually each party nominates one arbitrator (who is supposed to be impartial and independent), and the two co-arbitrators select the third, who acts as the chair. Usually, the party-nominated arbitrators allow the party who nominated them to provide them with a list of acceptable candidates, or at least identify some key qualifications that the chair should fulfill. This ensures the dispute is heard by someone who fully understands the issues.

Decision-Making Process

A court will strictly follow the applicable rules of civil procedure, including evidentiary rules. By contrast, arbitrators have much more flexibility. Unless the parties state so in the arbitration clause, the arbitrators are not constrained by any specific rules of evidence. Arbitrators may consider and weigh whatever evidence they want, even if such evidence would be typically excluded in a court trial. In addition, arbitration minimizes or excludes exposure to punitive damages, which are generally not allowed under most arbitration rules.

Relationship Considerations

Many people feel arbitration is less confrontational and more "genteel" than court litigation. If the parties have a long-standing business relationship that they would like to maintain, arbitration may be less damaging than litigation. The parties may also agree on so-called "step-up" clauses which require them to first negotiate any disputes in good faith (often in a mediation), and only if such negotiations fail, to arbitrate. The faster speed of an arbitral process may provide an additional benefit to the parties, since a quick and final resolution helps put the dispute behind them and move on with their commercial relationship.

Drafting Tips

As seen above, in certain constellations, arbitration lends itself as the dispute resolution method of choice. Classic examples include when the award has to be enforced internationally; the disputed matter is strictly confidential; or the matter at stake requires highly specialized expertise on the part of the trier of fact. Conversely, there are situations such as straightforward domestic loan payment claims, or when discovery is necessary to establish claims, or when the parties want to preserve their right to appellate review, that make court litigation preferable.

For all other situations, a careful analysis is necessary. The drafter of the dispute resolution clause should consider the most likely dispute and the most likely roles of the parties (i.e., which party is expected to be the claimant and which the respondent). Some further tips:

- One should also keep in mind that an agreement on the dispute resolution mechanism is much easier to achieve during the contracting stage, when there is no dispute and the parties are in a cooperative mode.
- The parties and their counsel should determine whether litigation or arbitration is the better dispute resolution mechanism for their specific transaction. One option is also to carve out certain claims. For instance, one could generally agree on arbitration, but provide for court litigation in case of straightforward payment claims (if enforcement is sought locally). Conversely, the parties may provide for litigation as the default dispute resolution mechanism, but agree to arbitrate disputes relating to post-closing purchase price adjustments. Instead of having such a dispute decided by an "independent expert" from one of the big accounting firms (who are often conflicted), parties may want to choose arbitration before a panel of qualified arbitrators.
- The dispute resolution clause needs to be drafted in a clear and concise way. Otherwise, additional disputes may ensue, and instead of providing guidance for solving a dispute, the clause will do the exact opposite.
- The dispute resolution clause should be tailored to the specific needs of the parties and the transaction. Not all deals require the same clause. Copying and pasting clauses from other contracts should be avoided. Instead, international arbitration counsel should get involved from the beginning (and preferably not five minutes before the signing) and be given an opportunity to review the entire deal structure so that an appropriate dispute resolution clause can be drafted.

Oliver Armas is a Partner at Chadbourne & Parke, LLP where handles complex domestic and international disputes. He has an extensive practice in U.S. federal and state courts and routinely represents foreign and domestic clients in arbitrations before the ICC, AAA/ICDR, LCIA, ICSID and other arbitral tribunals. Thomas Pieper is a Partner at Chadbourne & Parke, LLP and focuses on complex international dispute resolution, with a particular emphasis on Latin American and European parties. He has successfully represented foreign and domestic clients in large international cases before German, Mexican and U.S. courts, as well as in international arbitrations, both before arbitral organizations such as the ICC, the AAA and in *ad hoc* proceedings. He also assists clients in FCPA-related investigations.

Ontario Adopts UNCITRAL Model Law for Commercial Mediations

By Doug Harrison

There are new and important advantages to mediating a commercial dispute in Ontario, as compared to other North American jurisdictions. With the October 25, 2010, enactment of the *Commercial Mediation Act, 2010*, S.O. 2010, c. 16, Sch. 3 ("CMA"), parties settling a commercial dispute through mediation are able to register their settlement agreement with the Ontario Superior Court of Justice, gaining the advantage of having it treated as a judgment for enforcement purposes. The CMA also provides parties involved in the mediation of a commercial dispute with more certainty about the appointment of mediators, the conduct of the mediation and the confidentiality of the process.

Ontario became the second jurisdiction in Canada, after Nova Scotia, to adopt legislation of this nature. Like its Nova Scotia counterpart, the Ontario CMA is based on the UNCITRAL Model Law on International Commercial Conciliation (2002), which is also the basis for similar legislation in ten states and the District of Columbia.[1] The CMA applies not only to mediations of commercial disputes conducted in Ontario but also to those governed by Ontario law. Accordingly, parties who include dispute resolution clauses in their commercial agreements and wish to avail themselves of this new legislation should consider stipulating that any mediation be governed by Ontario law or be held in Ontario.

Importantly, if an Ontario mediation of a commercial dispute results in a signed settlement agreement with which a party fails to comply, another party wishing to enforce it may now apply to a Superior Court judge for judgment in the terms of the agreement or to the Registrar of the Superior Court for an order authorizing registration of the agreement with the Court. The Registrar must make such an order unless it is shown that a party did not sign the settlement agreement, did not consent to its terms, that the settlement agreement was obtained by fraud, or that it does not accurately reflect the terms agreed to. Once this order has been obtained, the agreement can be registered with the Superior Court, which would have the effect of giving it the same force and effect as a judgment of the Court. Arguably, it could then be registered in other Canadian provinces or territories, or the United Kingdom, under the applicable reciprocal enforcement of judgment rules.

The CMA applies to mediations of commercial disputes only, whether contractual or not, unless parties agree not to have the Act apply to their mediation, or the mediation is governed by the mandatory mediation rule of the Ontario *Rules of Civil Procedure*. Family law disputes or disagreements with insurers over accident benefits are not considered to be commercial disputes. The CMA also does not apply to mediations under or relating to the formation of a collective agreement, a computerized or other form of mediation in which there is no individual acting as the mediator, or to attempts by judges or arbitrators during the course of a legal proceeding or arbitration to promote a settlement. The CMA binds the Crown (i.e., the federal government, or a provincial or territorial government) and also provides parties with the flexibility to choose to have some, but not all, of its provisions apply to a mediation. Mediations commenced before October 25, 2010, the date on which the CMA came into force, are not subject to the Act.

A further benefit is that parties have greater certainty that the mediators they select are appropriate. Mediators are required by the CMA to disclose any current or potential conflict of interest and any circumstance that might give rise to a reasonable apprehension of bias. This duty to disclose continues until the mediation is terminated. A conflict of interest is deemed to occur if a mediator has a financial or personal interest in the outcome of the mediation, or has an existing or previous relationship with a party or a person related to a party to the mediation. Once appointed as a mediator, that individual cannot also be an arbitrator of the dispute or a related dispute unless the parties agree.

Once appointed, a mediator has a positive duty to maintain fair treatment of the parties throughout the mediation, taking into account the circumstances of the dispute. Parties cannot relieve the mediator from complying with this obligation. As between the parties, the mediator may disclose to a party any information that he or she receives from another party unless that other party expressly asks the mediator not to do so.

Information relating to the mediation (that is not otherwise public or considered by the parties to be non-confidential) must be kept confidential by the parties, the mediator and anyone else involved in the conduct of the mediation. However, disclosure of such confidential information can be made if the parties agree or if required (a) by law, (b) in order to carry out or enforce a settlement, (c) for a mediator to respond to a claim of misconduct, or (d)

to protect health or safety. Similarly, absent consent of the parties (and, if necessary, the mediator), no information concerning the mediation is discoverable or admissible in any judicial, arbitral or administrative proceeding, unless that information is required (a) by law, (b) in order to carry out or enforce a settlement, or (c) for a mediator to respond to a claim of misconduct.

The CMA states that parties can agree not to proceed with arbitral or judicial proceedings before a mediation is terminated. However, an arbitrator or a court may allow the proceedings to proceed if they are necessary to preserve a party's rights or are in the interest of justice (note, however, that agreeing to mediation tolls any applicable limitation period under section 11 of the Ontario *Limitations Act, 2002*). The commencement of an arbitral or judicial proceeding is not of itself to be regarded as a termination of the agreement to mediate or of the mediation.

Endnote

1. The *Uniform Mediation Act*, adopted in 2001 (amended in 2003) by the National Conference of Commissioners on Uniform State Laws, which is influenced by the Model Law and the principles on which it is based, has been enacted in Idaho, Illinois, Iowa, Nebraska, New Jersey, Ohio, South Dakota, Utah, Vermont and Washington. The uniform act was introduced in the New York State Legislature in 2012.

Doug Harrison is a partner in Stikeman Elliott's litigation section based in the Toronto office. His practice is focused primarily in the areas of general corporate-commercial litigation and arbitration, environmental litigation, product liability, defamation and insolvency.

Dispute Resolution in China

By Cheryl L. Davis and Yao Fu Bailey

In today's increasingly global economy, doing business internationally has practically become the norm. If an agreement with an entity based in another country hasn't already crossed your desk, one is probably in your (and your company's) future. While relationships with Chinese companies are becoming more and more common, doing business in China is still relatively uncharted territory for U.S. companies both from a business and a legal standpoint. In addition to the many business points which you'll have to negotiate with your Chinese counterpart (such as exchange rates and payment arrangements), one of the most basic legal issues you'll have to address is the question of dispute resolution.

Like many commercial agreements, the draft agreements you'll receive from Chinese entities are likely to include a provision setting out the forum and manner of dispute resolution. And, while your default may be to cross out the language making China the chosen forum, you should know most Chinese entities will not agree to any other jurisdiction. Based on experience practicing in China and in the U.S representing U.S. parties entering into agreements with Chinese nationals, we've found that Chinese entities usually insist that any disputes must be resolved in China. That being said, the U.S. entity still has some ability to negotiate how potential disputes may be resolved.

There are usually two options for dispute resolution: litigation or arbitration (or mediation or other forms of alternative dispute resolution). As you can imagine, even aside from the language and cultural differences, the Chinese legal system is very different from our own. As a practical matter, it can be extremely difficult for a U.S. company to litigate against a Chinese party in a Chinese court, especially if the case is not being tried in one of China's major cities. If the Chinese company is based (or has a supportive network) in the relevant jurisdiction, the local court might be influenced in your adversary's favor. The Chinese entity might take advantage of the net of "guanxi" (loosely translated as relationships) to influence the court.

Even apart from the guanxi issue, there are substantive differences in the legal systems that can put a U.S. company at a distinct disadvantage. For example, the Chinese court system does not provide for the same type of discovery to which U.S. attorneys are accustomed; counsel are not always required to exchange evidence. If your company has not already established a working relationship with the Chinese entity at issue and / or if it doesn't expect to establish a subsidiary or affiliate inside China, we would strongly recommend you choose arbitration rather than litigation.

There are several well established, internationally known arbitration tribunals in China who have been handling international arbitrations for many years. As a result, they tend to be more knowledgeable and experienced in handing international disputes than the judges in Chinese courts. These tribunals use Chinese arbitrators who have been trained or studied overseas, and some have non-Chinese arbitrators available. The procedural rules for arbitration are often more straightforward than the procedures of the Chinese courts, and the courts will also enforce arbitration awards. Some arbitrators have even been criticized by Chinese companies for not favoring Chinese parties; this is a good sign for U.S. companies considering arbitration in China.

While many Chinese entities still tend to prefer litigation over arbitration, more often than not, we have found them willing to agree to arbitrate inside China. The Arbitration Law of the People's Republic of China, which was enacted on August 31, 1994 ("ALPRC"), is the governing law for arbitrations conducted in China. It incorporates the "best practices" of international arbitration with the goal of reassuring foreign parties who do business (and therefore may have disputes) in China. While we cannot vouch for any particular arbitration tribunal, there are three that are the most internationally prestigious and most frequently used for international disputes in China: the China International Economic and Trade Arbitration Commission ("CIETAC"), the Beijing Arbitration Commission ("BAC"), and the Shanghai Arbitration Commission ("SAC").

CIETAC is the largest and oldest of the three, having been founded in 1956 (when it was known as the Foreign Trade Arbitration Commission). CIETAC's headquarters are located in Beijing, but it has subcommissions in Shengzhen, Shanghai, Tianjin, and Chongqing. While it is subject to the ALPRC, CIETAC also has its own arbitration rules. CIETAC's arbitration awards are enforced in more than 140 countries (pursuant to the New York Arbitration Convention). According to its website, CIETAC is "independent of the administrative organs, and free from any administrative interference in handling cases."[1] One service CIETAC provides that might be of interest to your company is "the combination of arbitration with conciliation, a practice which is internationally known as the 'Oriental Model.' It not only encourages dispute resolution

but also helps to maintain friendship and cooperation between the parties. It's an example that more and more foreign arbitration institutions are following."[2]

BAC was founded in 1995 pursuant to the ALPRC. BAC consists of more than 200 arbitrators, and according to its website, it focuses primarily on "contractual and property-related disputes, both commercial and international."[3] Like CIETAC, it prides itself on its independence and impartiality, and its arbitrators are trained in international ADR practices and procedures. In 2009, it handled 72 cases that involved parties from outside of China.

SAC was also founded in 1995 pursuant to the ALPRC. SAC currently has over 800 arbitrators and according to its website, it handles: "contractual disputes, real estate disputes, engineering project disputes, financial disputes (including disputes over insurance, futures, stocks, financing, etc.), maritime transportation disputes, and economic disputes over international trade, international agency, international engineering projects, international investment, and international technological cooperation and so on."[4]

Some of the key factors to consider about the Chinese arbitration system are:

1. There must be a valid arbitration clause in which the parties express their consent to arbitrate in China;
2. The parties may appoint either Chinese or foreign arbitrators;
3. The parties may choose the applicable law to be used in the arbitration. There is an exception to this rule, however. Where the dispute arises in connection with (i) a joint venture with a Chinese party, (ii) an entity wholly owned by a foreign party or (iii) contracts for joint exploration of natural resources, Chinese law must apply;
4. The parties may engage foreign attorneys to represent them in the arbitration process;
5. Arbitration awards are final and cannot be appealed to Chinese courts. The courts will, however, uphold and enforce the awards.

Since an arbitration clause is a prerequisite to arbitration, CIETAC has two model clauses on its website:

Model Arbitration Clause (1)

> Any dispute arising from or in connection with this Contract shall be submitted to China International Economic and Trade Arbitration Commission (CIETAC) for arbitration which shall be conducted in accordance with the CIETAC's arbitration rules in effect at the time of applying for arbitration. The arbitral award is final and binding upon both parties.

Model Arbitration Clause(2)

> Any dispute arising from or in connection with this Contract shall be submitted to China International Economic and Trade Arbitration Commission (CIETAC)_____Sub-Commission (Arbitration Center) for arbitration which shall be conducted in accordance with the CIETAC's arbitration rules in effect at the time of applying for arbitration. The arbitral award is final and binding upon both parties.[5]

Most agreements include a simple arbitration clause similar to the one proposed by CIETAC. Clarity is always more important than simplicity, however, and if an arbitration clause is in any way ambiguous, it could be deemed invalid and could prevent the tribunal from arbitrating the dispute. For example, if the clause provides the parties with the option of arbitration or litigation, that language will invalidate the provision. Likewise, the clause cannot offer the parties a choice of arbitration tribunals, and the tribunal selected must be listed by its exact name. The need for this requirement is apparent where there are two arbitration tribunals in the same city, such as Beijing, where both BAC and CIETAC operate. While the parties can subsequently correct invalid arbitration clauses, the need for such amendment effectively empowers one party to veto arbitration simply by refusing to sign the proposed amendment.

In addition to a clear and valid arbitration clause, there are other factors that should be considered and spelled out with respect to the dispute resolution process. As stated previously, a specific arbitration tribunal must be identified. If you choose CIETAC, you should specify the arbitration center you want to select (or the name of the city where the arbitration center is located). Beijing, Shanghai and Shenzhen are the most popular cities in which to conduct an international arbitration, since they are more convenient for travelers outside of China and there are more experienced arbitrators living in these cities.

It is also very important to identify the language to be used in the arbitration process. If the agreement is silent on this point, the arbitration will automatically be conducted in the Chinese language, which will put a foreign party at a distinct disadvantage. As you will find out when negotiating an agreement with a Chinese entity,

even when the agreement is written in both Chinese and English, the Chinese party typically insists on the Chinese version controlling in the event of any conflict. While you will probably get some resistance from the Chinese entity if you request that English be the language of the arbitration, you may be able to obtain the Chinese entity's consent if you're willing to accept Chinese being the controlling language with respect to the agreement.

The agreement should also set out the number of arbitrators to be used and state whether there will be any non-Chinese arbitrators. Although it will often be more costly to have non-Chinese arbitrators (and although the Chinese arbitration tribunals have been trying to maintain impartiality), it would still be prudent to have at least one arbitrator who is from a country other than China. It is also prudent to specify the governing law to be applied by the arbitrator. While in all likelihood the Chinese entity will insist upon Chinese law, you may be able to negotiate the application of U.S. law.

If the contract at hand is a substantial one (and/or if it is your company's first transaction with the Chinese entity), you will want to be extra cautious, crossing all "T"s and dotting as many "I"s as possible. For example, you can (and often should) take this opportunity to describe the discovery procedure you want to use in the event an arbitration proves necessary; you can even set out a sample timetable for when the parties should exchange evidence.

Although there may be circumstances which warrant litigating in China, much of the time it's wisest for a U.S. company to opt for arbitration. China's arbitration system has a long history in resolving both domestic and international disputes (aided by an underdeveloped court system and the strong encouragement of the Chinese government over the years). Over the years these tribunals have gathered a large number of capable and experienced arbitrators, both from inside China and outside China, and have striven for independence and impartiality. As a result, it seems that more and more foreign parties are willingly choosing to arbitrate in China—as reflected in the increasing number of international arbitrations handled by these tribunals. But, you need to remember that if your company chooses arbitration, that is only the start of what you'll need to address in the dispute resolution section of your agreement.

Endnotes

1. *See* http://www.cietac.org/index.cms.
2. *Id.*
3. *See* www.bjac.org.cn/en/about_us/index.html.
4. *See* http://www.accsh.org/accsh/english/node62/node63/u1a208.html.
5. *See* http://www.cietac.org/index.cms.

Cheryl L. Davis is a litigator who concentrates in intellectual property matters (particularly copyright and trademark cases), employment, and real estate/construction related matters. She has also represented theater clients in connection with a variety of contract and corporate issues. Yao Fu Bailey's practice focuses on real estate, with a concentration in commercial leasing and commercial and residential real property transfer, construction law, and corporate law. They are both with Menaker & Hermann, LLP based in New York City.

Negotiating Dispute Resolution Clauses in Argentina

By Juan Pablo de Luca

Parties seeking impartial and fair resolutions of disputes without delays and additional expenses must make a realistic evaluation of the features of both forms of arbitration in a specific country. Knowing the country's culture and jurisprudence may be a clear advantage and cannot be ignored when pursuing practical results.

The objective of this article is to provide with some suggestions when negotiating a dispute resolution clause for a project in Argentina.

One of the main aspects to be considered when negotiating a dispute resolution clause is to choose the form of arbitration: institutional arbitration clause or *ad hoc* arbitration clause.

Our suggestion is to choose the institutional arbitration clause. We believe that the administration of the proceedings by an institution guarantees a smooth running of proceedings with well-defined and predictable time frames and clarity on the issue of costs. It also offers an opportunity to have better control of certain essential aspects, such as terms periods to file writs, file defenses, produce evidence, and rule the case.

In our experience the institution we choose and designate as the arbitration administrator in our contracts is the Trade Arbitration and Mediation Center ("Centro de Mediación y Arbitraje Comercial") of the Argentine Trade Chamber. This institution provides reliable services, qualified and experienced arbitrators, and a simple, timesaving and complete set of rules.

However, cost-related concerns and common practice may lead to choose the ad hoc arbitration clause. This option may also be determined by request of the stronger party.

In this case, three significant aspects are to be taken into account before including an *ad hoc* arbitration clause. These are listed below.

a. The Autonomy of an Arbitration Clause

When parties agree to include an arbitration clause, all matters—even the validity or invalidity of the contract—are subject and subordinate to it. This is one of the main cornerstones of the arbitration.

Although this autonomy is a widely acknowledged principle, and that the international conventions ratified by the Argentine Republic establish the autonomy of an arbitration clause explicitly, and that it is even acknowledged by the Supreme Court of the Argentine Republic, some litigants—by way of filing defenses because of lack of jurisdiction—still seek to consider that the contract is not subject to this clause.

Our suggestion on this matter is highlighting the autonomy of the arbitration clause and making it clear that all matters arising from the contract—even those arising after a partial or total termination—are covered by this clause.

b. Procedural Matters

The lack of a procedural schedule is another problem that may be encountered during an ad hoc proceeding.

In our experience, the laxity in procedural regulations connected with evidence production, the potential questioning of the validity of the proceedings and the unreasonable interpretation and application of the constitutional principle of the right of defense, lead parties and arbitrators to permit irregularities in the application of procedural rules, which makes the process slower, more complex and more costly than previously anticipated.

Our suggestion is that procedural matters connected with term periods, defense filing, ruling term periods, process costs, evidence production term period and other procedural matters, should be established and determined as clearly as possible in a procedural schedule.

c. Arbitration Cost

In our experience, ad hoc arbitration clauses establish the costs that will be borne by each party. Each party shall bear its own expenses and jointly and equally share with the other parties the common expenses of proceeding. This regulation prevents conflicts at the moment of the ruling and disagreements on the costs allocation. Each party knows it will pay for its own expenses.

However, in some cases, these arbitration processes are preceded by or include judicial precautionary measures. The presiding judge may award costs for these proceedings.

This may not be free from conflict. As the arbitration proceeding costs are regulated by the arbitration clause and precautionary measure proceedings costs are awarded by the judge to one of the parties—generally the unsuccessful one—the resulting conflict of interpretations may render the process more difficult and expensive.

We consequently suggest parties should agree—in the clearest possible terms—how the arbitration costs are to be distributed.

These include not only those costs connected with the arbitration process but also those incurred when precautionary measures were granted by request of one of the parties involved.

We hope these pieces of advice are helpful in the use and application of the arbitration clause.

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Dispute Resolution by Arbitration in Poland

By Zdzislaw "Zee" Wieckowski

Introduction[1]

Since 1989, the year of the fall of the Berlin Wall and the commencement of market reforms in Central Europe, Poland has seen tremendous economic growth and the building of a liberal democracy. GDP per capita has risen from $2,406 in 1991 to $13,463 in 2011, according to World Bank data. Foreign direct investment is expected to be about $13 billion for 2012—roughly three to four times the FDI per capita of China. Poland was the only European Union country that did not register negative economic growth during the recession of the last few years.

As to its institutions, some have kept up with the pace of dynamic growth, and others have not. Whatever criticism one makes of the institutions that have not kept pace, one should recall that Poland effectively did not control its destiny, lacked a market economy and had a fairly moribund judicial system for fifty years between 1939 and 1989. Some of the best and the brightest of the professional classes were killed, left the country or were otherwise suppressed—six million people out of a population of thirty million died. There is the apocryphal story of the round-up of the faculty of Jagiellonian University in Krakow by the invading German forces and the deportation of the faculty to Sachsenhausen in 1939.

A return to normalcy does not come easily. Moses and the Israelites wandered in the desert for 40 years; one observation that has been made is that it takes two generations to clear the psycho-social bonds imposed by slavery. In that light, Poland still has another generation to run.

Poland has become an increasingly litigious society, both in the business world as well as the personal sphere. Unfortunately, the legal system has been neither transparent nor efficacious in dealing with disputes.

According to the World Bank / International Finance Corporation Doing Business Reports 2012 edition, Poland's judicial system does not rank highly among the 183 economies surveyed. On the ease of enforcing contracts, Poland ranks 68th compared to 38th for the applicable Organization for Economic Co-operation and Development ("OECD") average for "high income" economies in which Poland is categorized. Poland, according to the World Bank / IFC report, ranks directly behind Botswana, El Salvador and Chile, but ahead of several smaller Central European countries. In contrast, the United States ranks seventh.

The number of days from commencement of a suit to final judgment at the trial court stage averages 830 days, yet the OECD reports no significant reforms having been undertaken during the last several years. In contrast, the leader in this category is Singapore at 150 days and the OECD average is 518 days for the relevant "high income" group.

The courts themselves on a professional level have not been of an impressive standard. For example, there have been reports of judgments being entered without adequate service of notice being made upon the parties until enforcement of a judgment is sought—the courts are reported to be reluctant to re-open cases despite evidence of lack of service. Expatriates have been seen as deep pockets. Suits against expatriates (e.g., automobile accidents, disputes with landlords) have become such a problem that several embassies and multinationals doing business in Poland have staff dedicated to assisting expatriates with these issues. This last point is obviously not in the commercial context but underpins this writer's view that the courts are not the forum in which contractual parties (particularly entities with foreign capital) should choose to have disputes heard. Some lawyers, including Polish lawyers, are adamant about choosing arbitration, and even further suggesting that the arbitration not be heard by arbitral tribunals sponsored by one of the Polish organizations but by an alternate institution (such as the International Chamber of Commerce (the "ICC") or the London Court of International Arbitration.[2]

Note that this is not a criticism of Polish law as a body of law expressed in the continental system based upon the Napoleonic Code. Polish law actually has been pretty well harmonized with applicable European Union directives with a sprinkling of American influences (e.g. bankruptcy reorganizations, security interests (pledges) upon personal property collateral). It is the application of that law and the choice of forum that should be carefully considered. Choice of language should also be considered as well as (say in the case of ICC-sponsored arbitration) location. English is the language of choice for international business (with, not surprisingly, German second) and Warsaw as a choice for location in and of itself is not objectionable.

THE ARBITRATION REGIME

Enforceability of an Arbitration Award

Going directly to the issue of enforceability is not putting the cart before the horse. If an arbitration award is not normally enforceable why bother writing an arbitration clause in the relevant agreement or going to arbitration?

Recommended ICC Arbitration Clause

While one can embellish the arbitration clause, and it is often wise to do so (e.g., method of selecting arbitrators, place of arbitration, operative language, joinder of all claims between the parties, inclusion of the arbitration agreement in related documents to which ancillary persons such as shareholders or guarantors may be parties), there is the basic suggestion by the sponsoring organizations rules?

For example, the ICC rules suggest the following simple clause: "All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules."[3]

Often, the parties carve out emergency measures from the arbitration proceedings. As to contracts concluded after 1 January 2012, the ICC has instituted "emergency proceedings" pending the final choice of the arbitration panel; in order to not have ICC "emergency proceedings" apply, the parties specifically must opt out of that choice by explicit language.

International Arbitration

Poland is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") as is the United States and many other countries. As such, the usual provisions to recognize an award made in the territory of a state other than the state where enforcement is sought are applicable.

In general, to obtain enforcement, the party seeking enforcement must produce at the time of the application for enforcement: (a) the original award, duly authenticated, or a duly certified copy thereof and (b) the original agreement, or a duly certified copy thereof, selecting arbitration as the mode for dispute resolution.

Recognition and enforcement of the arbitration award may be refused by the enforcing court if the party against whom enforcement is sought furnishes proof that: (a) the parties to the agreement to arbitrate were under some incapacity, or the agreement was not valid under its governing law, or failing a choice of law not valid under the law where the award was made; (b) the party against whom enforcement is sought was not given notice of the arbitration proceedings, the appointment of the arbitrator, or was otherwise unable to present his case; (c) the award deals with a dispute not contemplated by or not falling within the terms of the agreement to arbitrate or it contains decisions on matters beyond the scope of the submission to arbitration (there is room for severability of awards to allow validity of the part of the award that is in compliance with the rules); (d) the composition of the arbitral authority, or the arbitral procedure, was not in accordance with the agreement of the parties, or failing such agreement was not in accordance with the law of the jurisdiction where the arbitration took place; or (e) the award has not yet become final or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

Recognition and enforcement may also be refused if the competent authority where the award is sought to be enforced finds that: (a) the subject matter of the dispute is not capable of settlement by arbitration under the law of that country; or (b) the recognition of the award would be contrary to the public policy of the country where enforcement is sought.

Poland made two reservations with respect to the New York Convention: (a) the convention only applied to Poland if the award was made in a contracting state and (b) the dispute arises out of a legal relationship, whether contractual or not, that is considered "commercial" under Polish law.[4]

Polish Domestic Arbitration Law and Enforceability of a Foreign Award

Generally speaking, Polish courts are favorably disposed to arbitration, whether domestic or foreign.

Polish statutory arbitration law is largely based on the United Nations Commission on International Trade Law ("UNCITRAL") model law on arbitration.[5] The Polish statutory arbitration law ("PAL") is part of the Polish civil procedure code and applies to arbitration held within the country as well as outside of Poland. Thus Polish law largely reflects the New York Convention.

In terms of the effectiveness of an arbitration agreement, PAL requires the agreement to be in writing and adequately drafted.

Recognition or enforcement of an arbitral tribunal shall be refused by the court if: (1) the dispute was not capable of submission to arbitration under the law or (2) the recognition or enforcement of the arbitral award or settlement reached before the arbitral tribunal would be contrary to fundamental "public policy" rules of the Republic of Poland.[6]

Moreover, the court will refuse recognition or enforcement of the arbitral award or settlement if: (1) there was no arbitration agreement, the agreement was not valid, is ineffective or has expired under the law applicable to it; (3) the award deals with a dispute not contemplated by or falling beyond the scope of the arbitration agreement, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted or falling beyond the scope of such submission, the court may refuse recognition and enforcement only of those parts of the award which contain decisions on matters not contemplated by or falling beyond the scope of the arbitration agreement; (4) composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or the law of the country in which arbitration took place; (5) the award has not yet become binding on the parties or has been set aside or suspended by a court of the country in which, or under the law of which, that award was made.

Other Notable Aspects of Polish Arbitration Law

One provision to keep in mind is that PAL would render invalid an arbitration agreement that entitles only one of the parties to file a request for arbitration. There have been occasions where a foreign party to a contract has sought to impose a one-sided arbitration election clause, and this writer has resisted such a one-sided election on the basic unfairness of such unilateral forum shopping and has also pointedly carved out from the enforceability opinion the provisions relating to a one-sided arbitration election regardless of the choice of law purporting to govern the arbitration agreement.

PAL contains a very useful tool in gathering evidence. While an arbitral tribunal cannot compel a witness to give evidence, PAL allows the arbitral tribunal, at the request of a party to arbitration, to request the common courts to compel a witness to appear before the common court. This testimony is given in court in front of a judge; to the extent that the parties to an arbitration might want or are required to keep the proceedings confidential , the commencement of a proceeding seeking the assistance of the common courts in gathering information loses the cloak of confidentiality.

Choosing Polish or Foreign Arbitration

The two most well-known arbitration courts in Poland are (i) the Arbitration Court at the Polish Chamber of Commerce and (ii) the Arbitration Court at the Polish Conference of Private Employers "Lewiatan." Certainly as between Polish parties, either of these, as well as other less well-known sponsoring organizations, will serve the purpose adequately. The Arbitration Court at the Polish Chamber of Commerce is the most active, hearing between 350 and 500 cases per year over the last few years.

A foreign investor or contract party may be, and should be, somewhat reticent about agreeing to arbitration in a Polish-sponsored forum; it is the experience of this writer that too frequently Polish arbitrators revert to a very formalistic approach in dealing with cases—much more formalistic than in the United States.

Conversely, a Polish contract party may be apprehensive about agreeing to arbitration abroad. The London Court of International Arbitration is a perfectly legitimate choice; however, the Polish party, and quite likely the foreign party, may be somewhat apprehensive about selection of a London arbitration forum due to cost.

On several occasions, at the suggestion of the writer, parties have agreed to ad hoc arbitration sponsored by the International Chamber of Commerce but taking place in Warsaw. It is this writer's experience that the Polish party may see this as an acceptable compromise. At the same time, the foreign party will be assured that the international component will keep the proceedings free of any local issues. Indeed, the Polish government has accepted ICC-sponsored arbitration, at least as to roadway construction matters, located in Warsaw, held in English, with Polish law governing the parties' relationship, before a three-judge panel. While travel costs may have to be taken into account (including those of the arbitrators), the parties are freer to choose the appropriate experts from whichever jurisdiction they select—one cannot emphasize the importance of having an international outlook on the arbitral panel.

Conclusion

In sum, arbitration is a recognized vehicle for dispute resolution in Poland. It is highly recommended that arbitration be sponsored by an international or non-local organization, with English as the language governing the proceedings. Polish law is not objectionable for the most part—but appropriate analysis should first be conducted. Location of such arbitration (cost issues aside) is less relevant.

Endnotes

1. This article is not intended as legal advice, and the reader should not rely on it as such; the article merely reflects the author's experience in arbitration proceedings involving Polish transactions. The reader should retain competent counsel in relation to the matters discussed in this article.
2. There are also other venues that are frequently cited: e.g., Zurich, Stockholm, Paris, New York.

3. It would be wise to list all documents relating to the transaction then being executed through a definitional reference.
4. Many countries have made these reservations.
5. The UNCITRAL rules suggest the following language for an arbitration clause: "Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force." The UNCITRAL rules suggest additional text as suggested in the text.
6. It is always wise, even if a foreign law is to apply to a contract with a Polish party, that the contract be reviewed for its compliance with Polish law so as to not run afoul of an unexpected application of the "public policy" exception.

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Arbitration in Mainland China—How to Make Your CIETAC Arbitration Clauses More International

By Jessica Fei and Damien McDonald

Introduction

While for foreign businesses operating in mainland China "offshore" arbitration, that is, arbitration with a seat outside mainland China, remains the preferred option for dispute resolution, it is not always available. This is because many China-related disputes must be arbitrated "onshore," that is, inside mainland China.

This prospect of arbitrating disputes in China can be a somewhat daunting prospect for some foreign companies. This is especially so for those companies that are unfamiliar with China and the "basic" Chinese arbitration model (i.e., Chinese seat / venue, Chinese language, Chinese law, Chinese tribunal, Chinese arbitration institutions (arbitration panels and rules), Chinese / civil law approach to evidence and procedure etc.).

This article is aimed at those foreign businesses that are unfamiliar with the basic rules on arbitration in China and are unsure how to deal with the basic CIETAC clause. It:

1. Introduces the PRC legal framework for arbitration and in particular the special rules why some disputes need to be arbitrated onshore. We also briefly explain the rules on the selection of Governing law (which needs to be part of any discussion on arbitration clauses in China).
2. Explains that while foreign businesses may find themselves having to arbitrate "onshore," this does not mean that their hands are completely tied as to the basic Chinese arbitration model. Companies can in many cases change many, but not all, of the points we have included in the "basic" Chinese arbitration model. We explain the most common changes made by foreigners to the standard CIETAC arbitration clause and why these changes are usually made.
3. Provides a couple of specimen CIETAC Beijing arbitration clauses with the common changes included.

Legal Framework for Arbitrations Seated in Mainland China

We discuss two key areas of PRC law which foreign companies need to know when dealing with China-related commercial contracts, A. Legal Restrictions on Arbitration and B. Governing Law.

A. Legal Restrictions on Arbitration

The two main restrictions on arbitration in China are the restrictions on the selection of offshore seats for non-foreign related disputes and the requirement that arbitrations in mainland China *must* be administered by an official Chinese arbitration institution.[1]

Foreign-related

In China, only "foreign-related" disputes can be validly arbitrated with a seat outside mainland China.[2] An agreement to arbitrate a non-foreign related (i.e., a domestic arbitration) offshore may be void. It therefore follows that a key question in this area is always whether a particular dispute is "foreign-related." The Supreme People's Court ("**SPC**"), the highest court in the PRC, in two judicial interpretations[3] has said that a "foreign-related" dispute must meet one or more of the following conditions:

1. **At least one of the parties is foreign.** A party is foreign according to where it is incorporated rather than its ultimate ownership. It is important to understand that for the purposes of this test, Hong Kong, Macau and Taiwan are considered "foreign." It is also worth noting that while a joint venture dispute between a foreign investor and a Chinese party is foreign-related, any dispute between the Sino-foreign joint venture (which is incorporated in China as a Chinese legal person) with a Chinese company shall be domestic dispute.
2. **The subject matter of the contract is outside mainland China**. There is no legislative or SPC judicial guidance on what this means, but will be determined by whether the subject matter of the contract is outside China. For example, the purchase of land outside China should fall within this category. If the subject matter / performance is, though, merely incidental to the performance of the contract inside China, it is unlikely that it will fall within this category.
3. **The legal facts for the establishment, alteration or termination of a civil legal relationship between the parties concerned take place outside mainland China**. This is the most uncertain of the three

requirements, not least because there is no SPC or legislative guidance in terms of its precise scope. A common observation in this area is, though, that the legal facts must genuinely take place outside China. This means that parties cannot simply fly to Hong Kong or Macau to execute an agreement and then seek to place it within the scope of this rule.

For obvious reasons, the first requirement is relatively certain in terms of its application. The second and third requirements are more uncertain (particularly the third) in terms of how Chinese courts may deal with them in practice. It is not recommended that they be relied on without seeking specific legal advice.

B. Governing Law

Governing law clauses are often negotiated in parallel with dispute resolution clauses. Unlike some other jurisdictions, China imposes restrictions on the parties' ability to choose neutral / foreign laws to govern their contracts. This is not merely an academic point; if the wrong law is chosen then there will likely be problems with obtaining the relevant government approvals (if required) for these contracts. Also, where a dispute arises and is subject to arbitration in mainland China, the governing law clause may be struck and PRC law will apply. If the arbitration is "offshore" and the tribunal applies the wrong law, there may ultimately be issues with enforcement in China on the grounds of public policy.

"Foreign-related" contracts

The basic principle on the choice of governing law in China is that only contracts which are *"foreign-related"* are allowed to adopt a non-PRC governing law. All other contracts which are not "foreign-related" must use PRC law. The test for "foreign-related" is the same as discussed above in relation to restrictions on choosing offshore arbitrations, except that the inquiry of "foreign-related" is decided at the *disputes* level.

Exceptions to the foreign-related rule

There are seven separate types of contracts for which PRC law must be used as the governing law. The most common one to be aware of is Sino-foreign equity or co-operative joint ventures.[4] Foreign law is also not a permissible choice of law where "the application of foreign law will be prejudicial to the social and public interests of the PRC"[5] and the "parties' choice of a foreign law represents an attempt to avoid mandatory laws, regulations and prohibitions."[6] While there is little or no guidance on these two restrictions, it is clear that the first prohibition is capable of very broad application. An example of a "mandatory law, regulation or prohibition" in the second restriction would be the seven types of contracts that we just mentioned must use PRC law.

Making the best of the position

Where your choice of governing law is limited to PRC law, it is important to remember to use this as part of your bargaining position to secure a more internationalised arbitration clause which we are about to discuss in the next section.

Internationalising an Arbitration Agreement for CIETAC Arbitration

Onshore Chinese arbitration does not necessarily mean that foreign parties have to accept the basic Chinese arbitration model (which we described in the introduction). There are in fact a number of ways to bring an "onshore" arbitration more in line with what foreign parties may expect in terms of international arbitration.

CIETAC Beijing

While there are many other arbitration commissions in China, such as the Beijing Arbitration Commission and Shanghai Arbitration Commission, the China International Economic and Trade Arbitration Commission ("**CIETAC**") is widely regarded as the most popular and safest choice for foreign business. It is the most well-known arbitration commission in China and on 24 September 2012 opened a sub-commission in Hong Kong.[7]

It has also, importantly, made a conscious effort to try and internationalise its practice over the past decade. For example, it has recently updated its rules for arbitration which came into effect on 1 May 2012 ("**CIETAC Rules 2012**").[8] Many of the revisions were aimed squarely at bringing CIETAC practice more into line with international practice.

Unfortunately, as at the date of writing this article there is a dispute between CIETAC Beijing (the Headquarters) and the CIETAC Sub-Commissions in Shanghai and Shenzhen. CIETAC has declared that, effective from 1 August 2012, it has suspended authorisation to Shanghai and Shenzhen.[9] While this has brought some uncertainty in this area, the most common sense precaution for parties (until this matter is resolved) is to ensure that they state CIETAC Beijing in their clauses (we have done this in our specimen clause below).

Changes to the Basic Chinese Arbitration Model

Seat and Venue

Under PRC laws, a foreign-related arbitration may be submitted to non-Chinese institutions (such as ICC) with

a foreign seat. However, a non-foreign related arbitration (such as a dispute between two WFOEs—wholly foreign owned enterprises incorporated in China, with no other foreign elements) must have a seat (that is, the legal place of arbitration) in mainland China. This is separate from the concept of the venue or the physical place in which the hearing may be held. There is no reason why the hearing cannot be held offshore, in Hong Kong or any other international location. While there is no distinct advantage in having the venue offshore (e.g. legally it will still be a Chinese arbitration and subject to the PRC Courts supervisory jurisdiction), it may be that the foreign party (for example, an investor in a Chinese company) is more comfortable with this option.

Though a foreign seat for foreign-related disputes might be generally preferred by foreign parties, it may not always be favorable. For instance, if assistance for interim measures from the Chinese court might be needed, choosing CIETAC in China might be better off for foreign parties as the Chinese courts are unlikely to render help to a foreign-seated arbitration.

Arbitrators—Off Panel

The selection of the tribunal is one of the most important steps in any arbitration proceeding. CIETAC has a panel system (which is required under the PRC Arbitration Law[10]). This means that, absent contrary written agreement, the parties can only appoint arbitrators listed on the CIETAC panel.[11] We would, however, recommend that foreign parties always expressly reserve in their arbitration clauses the power to appoint "off panel."

This is because, while the quality of the CIETAC panel is very high in terms of the expertise in PRC law, with many eminent specialists and leading scholars, it unnecessarily restricts the parties' right to choose their arbitrators. An express reservation to appoint off panel will allow parties to appoint anyone they want (subject to confirmation by CIETAC). This will be particularly important to foreign parties who will have greater scope for the appointment of senior international arbitrators from common law jurisdictions (with a more western orientation to issues such as evidence and, in particular, document production).

Arbitrators—Nationality

The second drafting tip in this area is to agree that the Chairman cannot be (and cannot ever have held) the nationality of either of the parties' ultimate parents. This is an important step in dealing with the real "hometown" advantage the Chinese parties may have in terms of CIETAC arbitration. There is, of course, a natural tradeoff in this area in that foreigners will also have to give up the chance of having someone from their own country appointed as Chairman.

Incorporating Other Arbitration Rules

The CIETAC Rules 2012 allow parties to modify the CIETAC Rules or adopt other rules, such as the ICC or UNCITRAL Rules.[12] Generally we do not consider it sensible to try and combine another institution's rules or UNCITRAL Rules with CIETAC-administered arbitration. This is because, while CIETAC may of course be able to administer ICC arbitrations, it is not the ICC and not expert at running ICC arbitrations. The CIETAC / UNCITRAL model also may give rise to potential challenges to the validity of clauses on the grounds that they provide for "ad hoc" arbitration (which is not permitted under PRC law because arbitrations need to be administered by Chinese institutions).[13]

IBA Rules

China is a civil law jurisdiction and arbitrations in China generally adopt the civil law approach to document production. This means that in China parties to arbitration proceedings are only generally required to produce documents which they rely on in support of their case and there is no requirement for them to produce documents which will harm their case.[14] Accordingly, common law-style document production will generally not be ordered unless the parties have expressly agreed otherwise.

By expressly agreeing to incorporate the International Bar Association's Rules on the Taking of Evidence in International Arbitration ("**IBA Rules**"), the parties will have a good basis for asking the tribunal to deal with document production along the common law / international arbitration practice lines in terms of request, relevance and objections. While the adoption of the IBA Rules will not necessarily replace or alter the existing, very broad, discretion that a CIETAC tribunal has in terms of procedure, it is a significant improvement on the basic Chinese model (at least from the foreign perspective).

Language

We recommend that where possible foreign parties try and obtain express agreement to the use of English language in the arbitration, rather than Chinese. This is for a number of reasons. Apart from having the arbitration conducted in the language that the foreign parties are familiar with, it also greatly expands the pool of international arbitrators from which parties can choose (see our comments above on expressly providing for "off panel" appointments).

A usual fallback from English language only is bilingual arbitration (i.e. using Chinese and often English as the language of the arbitration). While this is an acceptable and increasingly common compromise, bilingual arbitrations tend to add considerable complexity and

extra cost to the arbitration in that strictly speaking "everything"—correspondence, evidence, etc., all needs to be bi-lingual.

For completeness we also mention that it is otherwise essential to expressly stipulate the language (English, bi-lingual or otherwise). This is because under the CIETAC Rules 2012, unless a language has been agreed on by the parties, CIETAC will designate the language "having regard to the circumstances of the case."[15] Obviously, where no language has been provided for in the arbitration clause, there is a real risk that in cases where one party is Chinese (which is of course going to be the case in most, if not all, CIETAC arbitrations), CIETAC may specify Chinese as the arbitration language.

An English-only specimen clause for CIETAC arbitration seated in Beijing

> Any dispute, controversy or claim arising from or in connection with this Contract, or the breach, termination or invalidity thereof, shall be submitted to the China International Economic and Trade Arbitration Commission ("CIETAC") for arbitration. The seat of the arbitration shall be Beijing. The arbitral award shall be final and binding upon the parties. The arbitration shall be conducted in accordance with the CIETAC Arbitration Rules in effect at the date of the Request for Arbitration, subject to the following:
>
> (1) the arbitration shall be conducted exclusively in English. All arbitrators appointed must be fluent in written and spoken English. All documents filed and all oral submissions must be in English. Any party wishing to rely on documentary or witness evidence in any other language shall be responsible for providing an accurate English translation or interpretation of the same to the other party and to the arbitrators, at the same time as the original language version is provided. In the absence of such English translation or interpretation, such evidence shall be disregarded;
>
> (2) there shall be three arbitrators;
>
> (3) the presiding arbitrator shall in no circumstances be an individual who holds (or has at any time in his or her lifetime held) Chinese or [insert the nationality / ies of the foreign invested party's ultimate parent(s)] nationality;
>
> (4) the parties agree to the appointment of arbitrators from outside CIETAC's Panel of Arbitrators;
>
> This arbitration agreement shall be governed by the law of [ ];
>
> The parties agree to the adoption of the IBA Rules on the Taking of Evidence in International Arbitration.

A bi-lingual specimen clause for CIETAC arbitration seated in Beijing

The only change to the above clause will be point (1) as follows:

> (1) the arbitration shall be conducted in English and Chinese. All documents filed and all oral submissions must be in English and Chinese. Any party wishing to rely on documentary or witness evidence which is not in both languages shall be responsible for providing an accurate translation or interpretation of the same to the other party and to the arbitrators, at the same time as the original language version is provided. In the absence of such translation or interpretation, such evidence shall be disregarded;

Conclusion

We trust that this short article has made arbitration in China a little clearer for those foreign businesses not familiar with China and the China arbitration model. We also hope that by taking into account the drafting tips mentioned above, the standard CIETAC clause / basic Chinese model can be revised to make it closer to the international model (and as a result the prospect of arbitrating disputes onshore in mainland China a little less daunting).

Endnotes

1. See Article 16 of the PRC Arbitration Law, 中华人民共和国仲裁法, 31 August 1994.
2. See Article 20(7) of the Supreme People's Court Draft Provisions of Several Regulations on Dealing with Foreign Related Arbitration and Foreign Arbitration Cases for Lower Courts, 关于人民法院处理涉外仲裁及外国仲裁案件的若干规定 (征求意见稿), 31 December 2003. Although it literally translates as "Draft" it is rather more like "Interim" Opinion since absent further guidance from the SPC in this area, it is the most authoritative guidance on this point.
3. See Article 304 of the Opinions on Some Issues Concerning the Application of the Civil Procedure Law of the PRC, 最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见, 14 July

1992 and Article 178 of the Opinions on Several Issues concerning the Implementation of the General Principles of the Civil Law of the People's Republic of China (For Trial Implementation), 关于贯彻执行《中华人民共和国民法通则》若干问题的意见 (试行), 2 April 1988.

4. The Provisions on Several Issues Regarding the Applicable Law in the Hearing of Foreign-related Civil or Commercial Contract Disputes issued by the SPC, 最高人民法院关于审理涉外民事或商事合同纠纷案件法律适用若干问题的规定, 8 August 2007. The seven types of contracts include: Sino-foreign joint venture equity or co-operative contracts; contracts for Sino-foreign co-operative exploration and exploitation of natural resources; contracts transferring equity in Sino-foreign equity or co-operative joint ventures and wholly foreign-owned enterprises; contracts for the management by a foreign party of Sino-foreign equity or co-operative joint ventures established within mainland China; contracts for the purchase, by a foreign party, of equity in enterprises without foreign investment which are located within mainland China; contracts relating to the subscription by foreign parties to an increase in registered capital of a company without foreign investment which is located within mainland China; and contracts for the purchase by foreign parties of assets from enterprises without foreign investment which are located within mainland China.
5. The Provisions on Several Issues Regarding the Applicable Law in the Hearing of Foreign-related Civil or Commercial Contract Disputes, 最高人民法院关于审理涉外民事或商事合同纠纷案件法律适用若干问题的规定, 8 August 2007.
6. The Opinions on Some Issues Concerning the Application of the Civil Procedure Law of the PRC, 最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见, 14 July 1992.
7. Jessica Fei is on CIETAC's panel of arbitrators and used to work for CIETAC Beijing for a number of years.
8. For further discussion see: http://herbertsmitharbitrationnews.com/2012/04/19/the-new-cietac-arbitration-rules-a-move-towards-internationalisation/.
9. For further discussion on this topic see: http://herbertsmitharbitrationnews.com/2012/08/14/cietac-split-the-latest-developments-and-how-to-proceed/.
10. See Article 11 of the PRC Arbitration Law.
11. See Article 24(1) and 24(2) of the CIETAC Rules 2012.
12. See Article 4(3) of the CIETAC Rules 2012.
13. See further http://kluwerarbitrationblog.com/blog/2011/03/15/mixing-and-matching-arbitration-rules-in-mainland-china-%E2%80%93-the-pros-and-cons-of-using-the-uncitral-rules-in-cietac-arbitration-2/.
14. See Article 39 of the CIETAC Rules 2012.
15. See Article 71.1 of the CIETAC Rules 2012. Under the previous CIETAC Rules 2005, if parties fail to agree on a language in the arbitration agreement, the default language to be used is Chinese.

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Rethinking Mediation: Moving Beyond the Adversarial Model

By Steven Rabinowitz

I would like to expand your view of mediation, to help you understand it not only as a tool for settling litigation and saving costs, but as a method for adding value to any situation where conflict exists or may arise. To broaden your perspective, I will first begin by contrasting the adversarial mindset—which tends to color the mediation process and limit its efficacy—with a more collaborative approach; one that embraces mediation in its highest and best form, allowing those in conflict to reach resolutions that are not only mutually satisfactory, but sometimes inspired. I will then suggest ways to make the most of mediation by approaching it more as you would a negotiation, and less as you would a trial.

Changing the Perception of Mediation

Most lawyers see mediation as a form of alternative dispute resolution sometimes useful for bringing costly litigation to an end. They see the mediator's role as one of subtle or perhaps not-so-subtle arm-twister, someone who will point out the weaknesses in the other side's case and use the gravitas of his or her position, combined with skillful shuttle diplomacy, to nudge, push or even drag the parties to settlement. As for their own role in mediation, lawyers often believe they must don the armor of battle and convince the mediator their case is righteous. They envision mediation as a series of thrusts and parries, marshalling their facts and legal arguments like troops, playing out their offers and counter-offers like tactical maneuvers, striving to capture the lion's share for their clients, while minimizing the spoils to the other side.

But there is another way of perceiving and practicing mediation. A different paradigm where the mediator's role is much more coach than judge: a facilitator helping both sides negotiate at their very best, rather than an evaluator pressuring them to do as he or she determines. Under this paradigm, the lawyer's role becomes less warrior and more sage, engaged not to do battle, but to explain the legal implications of the facts at hand and help the client find options for resolving the conflict he confronts. Mediation does not have to be a zero sum game with winners and losers. Nor do parties in conflict have to accept the old saw that a good settlement is one where no one really gets what he wants. Instead, they can emerge from mediation satisfied that their most important needs were fairly met and, when mediation works best, delighted by how much value they have created.

The paradigm of mediation that I'm suggesting is not some radical vision or dewy-eyed fantasy. It is the model thousands of mediators have been trained in, and one that resonates with business people and business lawyers who understand the concept of win-win negotiation and appreciate the value of building better relationships. But because mediation is most often seen merely as an adjunct or alternative to litigation, rather than a process in its own right—and because litigators, rather than business lawyers often determine not only how mediation is conducted, but if and when it is utilized at all—mediation is too often used only after litigation exhaustion sets in and the parties' positions have hardened. By then it is colored by adversarial thinking, set in a win-lose framework that inhibits genuine communication and undermines the chance that those in conflict will adopt a joint problem-solving approach and realize the true promise of mediation—to enhance business interactions and unearth value before too much mud has been slung.

Inviting Corporate Counsel to the Mediation Table

Because mediators so deeply believe that mediation can not only heal conflict, but prevent it from erupting in the first place, we long for mediation to be the choice of first resort when conflict is on the horizon, not the one of last resort after litigation has chewed up more expenses and opportunity costs than the client can stomach. We want lawyers and their clients to enter mediation alive to its prospects and open to joint problem-solving, not blinkered by adversarial thinking, focused only on gaining the upper hand and thwarting the opposition. While mediators can often move the parties and their lawyers beyond the adversarial mindset, better to run the race without that hurdle there.

For the promise of mediation to be realized, it needs to be less the province of battle-scarred litigators and more the choice of enlightened business people. Once clients and their business counsel better understand the value of mediation and learn how to make the most of it—both in terms of knowing when to mediate and how to play their roles within the mediation process—they should turn to mediation more often and reap greater rewards when they do.

But the adversarial approach to conflict is deeply entrenched, and much of the litigation bar, to whom busi-

ness people typically turn when disputes arise, remains skeptical of mediation's value and threatened by its seeming encroachment on their turf. Mediators need the help of corporate counsel to move mediation beyond the confines of the adversarial system. We would like to see business lawyers assume a more active role in conflict management, rather than ceding that role solely to litigators. We need corporate counsel to embrace mediation as a valuable tool, so that we encounter the adversarial mindset less often and have greater opportunity to work with business-minded lawyers and their clients.

We mediators tout our ability to help those in conflict reframe their perspectives and then, through new eyes, find inspired solutions to seemingly intractable problems. But we, ourselves, have too long operated within the adversarial frame, focusing our outreach on judges and litigators, while largely neglecting corporate counsel. And since we promote our services primarily as a way out of costly litigation—indeed, since that's how mediation is largely understood—we underserve the larger business market where we can not only save costs, but add value.

With this article, I would like to readjust the mediation frame and invite corporate counsel to the table. Let me start with a brief description of how mediators see mediation, for it is when lawyers grasp the mediator's perspective that they are most effective in mediation.

Defining Mediation

All mediation involves parties in conflict, who turn to a mediator as a neutral third party to help them resolve that conflict, but not to decide its outcome (which is where judges and arbitrators come in). Within that broad definition fall a myriad of mediation styles and modalities, with many mediators varying and adapting their approaches depending on the nature of the conflict and the progress the parties are making toward resolution. Fundamentally, though, mediation operates across a spectrum ranging from evaluative to facilitative, with most mediators operating within the facilitative model.

Evaluative mediators, the kind most litigation lawyers seek, assess the strengths and weaknesses of the parties' viewpoints, envision possible solutions to that conflict, and then direct the parties towards those solutions through pointed questions and sometimes blunt critique. They tend to keep the focus of the mediation narrow, to shy away from underlying issues and emotions, and prefer separating the parties, rather than keeping them in the same room. In evaluative mediation, the parties are invited to stake out their positions, but then are encouraged to reevaluate them and reach a compromise. Such mediations usually culminate in an exchange of bids and asks until some midpoint is reached.

Facilitative mediation—which should appeal to corporate counsel, as it favors negotiation over litigation—is more concerned with exchanging perspectives than evaluating them; with creating an environment where the parties can arrive at mutually agreeable solutions, rather than with setting agendas for how conflict should be resolved. Facilitative mediators allow the mediation to flow more freely and broadly, helping the parties explore all the issues raised by their conflict and, if necessary, deal with underlying emotions. They discourage positional bargaining and instead invite the parties to discuss their underlying interests. Resolutions are reached not through the clash of competition, but through collaborative problem-solving, often yielding something finer than mere compromise—the chance to not just divide the pie, but perhaps enlarge it.

While evaluative mediation has its place— even the most facilitative mediator will sometimes suggest that a party's views are way off base—only facilitative mediation, with its preference for interest-based, rather than positional, bargaining offers a true alternative to the adversarial approach for resolving conflict. This is not to say that facilitative mediation operates in some naïve why-can't-we-all-just-get-along world. Quite the contrary. Facilitative mediators acknowledge parties' differences and encourage them to share their often differing perspectives on how the conflict arose. Their mission is not to artificially tamp down disagreement, but to ensure that each party is truly heard *and* hears the other. They want parties in conflict to face the real differences between them and, once they do, to consider their priorities and engage in informed give and take.

Though it may seem counterintuitive, this approach often rebuilds relationships and uncovers opportunities for joint gain. For it is when parties in conflict fully understand what that conflict is about, and fully appreciate not only where their interests collide but might align, that they can bargain most constructively.

So when you think of mediation, think facilitative, not evaluative. See mediation as more than a tool for curtailing the costs of litigation, but for avoiding it and its attendant mindset altogether. Once you think outside the confines of the adversarial context, and come to see mediation in its highest and best light—as guided negotiation, rather than refereed fight—you will discover its value in countless contexts beyond litigation.

Opportunities for Mediation

Once seen as guided negotiation, and as a way to facilitate agreement instead of merely to resolve discord, the

possibilities for mediation abound. Mediators can help repair frayed relations among board members or business partners. They can work with corporate counsel to resolve employer/employee disputes and address labor/management conflict. Mediation can guide sensitive business combinations or corporate mergers to ensure that things start off on the right foot. And if partners decide to separate or businesses to unwind, mediation can smooth that process considerably. Turn to mediation early and often, before disagreements degrade to costly litigation.

Mediation is also the ideal choice when the stakes are too low for litigation to be an option, but the aggravation too high to simply let the conflict go. Minor landlord/tenant disputes, disagreements over commissions, and debates over royalties, readily come to mind. And so do more complex issues where the stakes are higher, but litigation is not generally an option, such as contending with community groups or coordinating with the government.

Understanding the Interplay Between Mediators and Lawyers

Lawyers often see the value of mediation as a tool when all else fails, but question whether involving mediators at the outset of conflict is redundant or, worse, a threat to their own roles. "I know how to negotiate," they say, "I've settled scores of cases. What can a mediator do that I can't?" Yet mediation adds value, even when a lawyer is a brilliant negotiator, because there are certain things a mediator can bring to the negotiation process that a lawyer generally cannot.

Even in productive negotiations, the dynamic changes for the better when a strictly neutral third-party—a mediator—is at the negotiation table. The tenor of the discussion becomes more civil, perhaps not dramatically among congenial negotiators, but still perceptibly so. Difficult conversations become easier when a mediator guides and modulates the discussion. Misplaced notions about the other side are more easily corrected when it is the mediator providing the reality check, rather than the lawyer across the table. And useful information is more easily teased out when the mediator and not the adversary is asking the questions.

With a mediator's encouragement, lawyers can exchange proposals and counterproposals without worrying about appearing weak for talking resolution in the first place. And because mediators are looking at the conflict from the outside in, instead of the inside out, they can see things that even the most open-minded lawyer might miss. They aren't caught up in the power plays or emotions so often present in conflict, so they can help reframe the issues to allow more productive dialogue.

A good mediator respects the lawyer's role in a mediated negotiation. Rather than push the lawyer aside, he will enlist his or her help in explaining the legal principles that impact the negotiation, and will call upon the lawyer's experience in brainstorming options for resolution. Mediators respect the lawyer/client relationship and support it, encouraging the lawyer and client to think through critical issues before they are aired in the mediation. They can often act as a cushion between lawyer and client, breaking bad news to the client and thus sparing the lawyer that task, or floating trial settlement balloons that if lofted by the lawyer might strike the client as insufficiently supportive.

In the final analysis, there is nothing to lose by choosing to mediate conflict. The costs are not great, adding but one person to the mix, often for just a single session, with the costs split by all those involved. Furthermore, because mediation usually produces resolution faster and more efficiently than unguided negotiation, it yields a significant cost savings overall. And even where mediation doesn't lead to a final resolution, the parties and their counsel still learn much about their situation and each other, perhaps paving the way for future settlement or, if settlement isn't possible, better informing their litigation strategy.

Making the Most of Mediation

To make the most of mediation once you have decided to apply it to the conflict at hand, think like a mediator, not like a litigator. That is, you should underpin all your planning and conduct with a commitment to keeping the process collaborative, so that it does not degrade to a purely adversarial one. This does not mean you have to be unassertive; as with any representation, the client's needs are paramount. But it does mean that you should not only advocate, you should listen. For the most productive mediations, just like the most productive negotiations, are the ones where the parties and their counsel are open to the possibility that they can make trades, and even concessions, for mutual gain.

Preparation, of course, is essential. And while you should master the facts and understand the applicable law, you also need to fully understand your client's business and consider the options for resolution. Many lawyers in mediation make the mistake of thinking only in terms of bargaining tactics and negotiating positions. As they prepare their clients, they do not take the time to explore and understand the interests underlying those positions. But if you enter mediation armed with that understanding, you will have the flexibility to overcome obstacles to resolution, finding alternative means to satisfy your client's needs.

One of the keys to success in mediation is to look beyond your own client's perspective; to step into the other side's shoes. This shift in perspective can help enormously in shaping your own approach to the mediation, as it may allow you to see what would satisfy the other side's interests and then construct solutions that mesh with your own client's concerns.

Conclusion

Expanding your perspective is exactly what I've asked you to do in this article. View mediation only as a way out of litigation and you miss opportunities to benefit from applying it elsewhere. Leave mediation solely in the hands of litigators and you will almost always get a litigation approach, rather than one also informed by a more transactional view. If corporate counsel embrace mediation, bringing their business savvy and negotiation skills to bear, more productive and creative mediations will result. Perhaps one day, with corporate counsel's participation, mediation will come to be seen not as *alternative* dispute resolution, but as the *primary* means for resolving conflict and promoting better business relationships.

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Dispute Resolution in Korea: Points to Keep in Mind When Drafting the Terms of Your Next Commercial Agreement

By Andrew Park

Most international commercial contracts contain a dispute resolution provision of one type or another. This article discusses the two most common dispute resolution forums available in the Republic of Korea ("Korea") and will hopefully provide guidance on how best to structure the dispute resolution provision in your commercial contract with a Korean party.

As a preliminary matter, it is important to point out that an ideal dispute resolution provision will provide for disputes to be resolved in a forum that is most familiar and convenient for your company or organization. Of course, this is not always possible. In those cases where your company or organization is entering into a contractual relationship with a Korean party and / or doing business in Korea, and the dispute resolution provision calls for a forum in Korea, there are options for you to consider.

In general, there are three common forums for a party doing business in Korea or with a Korean entity. They are: civil (court) actions, alternative dispute resolution via arbitration or court-administered mediation, and international litigation pursuant to the World Trade Organization or bilateral / multi-lateral free trade agreements. The latter forum—international litigation—concerns disputes between countries (State-State disputes) and between an investor and a nation (Investor-State disputes). The focus of the article will be on international commercial contract disputes between private parties and, hence, attention is devoted to civil actions and alternative dispute resolutions.

I. Civil Actions

Korea's civil court system is modeled after the German system and is also similar in certain respects to the Japanese system. It is, therefore, quite distinguishable from common law systems such as that of the U.S. For disputes involving the terms of an international commercial contract, the relevant civil courts consist of the trial level district courts, the appellate level high courts, and the Supreme Court, the nation's highest court. Within the district courts and the high courts are divisions for civil, criminal, bankruptcy, patent, and other cases. The district courts are presided over by either one judge or by a panel of three judges, depending on the size of the claim involved. For the high courts, all cases are decided by a panel of three judges. Similarly, most Supreme Court cases are presided over by a panel of three judges, but decisions in cases that are considered to be of particular importance are rendered by all thirteen justices of the Court.

In general, judges tend to be less active in presiding over civil actions than their counterparts in common law jurisdictions, especially when considering that Korean civil courts do not utilize a jury system. Part of the reason for this judicial "inactivism" lies with rules for civil procedure that tend to place more emphasis on the pleadings rather than oral discussion / arguments. Also, as discussed below, there are no formal discovery proceedings, as in the U.S. Nonetheless, recent changes in Korean civil practice include opportunities for broader document production and there is an increasing emphasis on oral advocacy.

Korea's rules of civil procedure include statutes of limitations, the periods of which vary depending on the nature of the claim. For instance, breach of contract claims and tort claims are typically covered by a ten-year statute of limitations.

Assuming that there is no statute of limitations issue, a civil proceeding for breach of contract is commenced by the filing of a written complaint at the district court. The essential elements of the complaint include the names of the parties, the facts of the claim, and the relief sought. If the court is satisfied that the complaint meets the minimum requirements, it will serve the complaint on the defendant. The defendant has 30 days from the date of service to file its response. Thereafter, the court will typically schedule one or two hearing dates and additional pleadings are usually filed. All hearing dates and deadlines for filing pleadings are set by the court rather than by statute.

Unlike U.S. civil procedure, there is no formal discovery process. Thus, for example, there are no procedures for depositions, interrogatories, and litigants generally do not have a duty to preserve or to produce documents / information. However, documents that are identified in pleadings or documents that the opposing party has a right to inspect by statute, and documents arising out of certain other limited situations, may be subject to production if requested with specificity by the opposing party and ordered by the court.

Another notable distinction from U.S. civil procedure is the absence of the concept of the attorney-client privilege. Korean civil procedure does provide a narrow privilege to confidential information obtained from a client during the course of providing legal services to the client. In most situations, however, an attorney can be compelled to testify as to matters outside of this narrow scope of privilege.

Evidence is presented to the court in documentary form and via oral testimony. Oral testimony provided by

experts and other witnesses is presented by a party during direct examination. The opposing party may cross-examine witnesses and there may be an opportunity for redirect, if permitted by the judge.

In general, Korean courts may order the following three types of remedies: money damages or specific performance; declaratory relief; and constructive relief. Korean law does not provide for punitive damages.

Interim remedies are somewhat common in Korea in order to prevent the defendant from concealing or disposing of its assets and to otherwise preserve assets for enforcement. It is also a useful procedure to gain leverage on defendants in settlement discussions. Interim remedies are particularly common in cases involving smaller defendants. The two most common types of interim remedies are preliminary attachment and preliminary injunctions. In both cases, the party seeking the interim relief must make a prima facie showing that it will be irreparably harmed if the requested relief is not granted.

It is worth noting that interim remedies are also available in cases involving foreign court proceedings and arbitrations that are either pending or about to be commenced. Seeking an interim remedy is an ex parte proceeding.

The losing party at the district court level may appeal to the high court within 14 days of the date of service of a judgment. Otherwise, the judgment becomes final and binding. An appeal may be based on the grounds that the district court erred in connection with the findings of fact and / or the conclusions of law. The appeal proceedings are similar to the trial proceedings. Moreover, the appellant is permitted an opportunity to make new allegations and to produce new evidence. The high court will determine the district court's decision de novo, and, therefore, it may re-examine the evidence and witnesses, and is not bound by any factual or legal determinations of the lower court.

The high court's decision is further appealable to the Supreme Court. The Supreme Court does not have certiorari powers to reject an appeal. However, the Supreme Court only reviews cases in which there is a question of law, not of fact. As such, the Court generally does not review the evidence unless the issue on appeal relates to the misapplication of the rules of evidence by the lower court.

II. Alternative Dispute Resolution

Alternative Dispute Resolution, or ADR, includes arbitration and court mediation. Although most commercial disputes are still resolved by Korean courts, there has been a clear and steady increase in the number of disputes resolved by ADR.

The Korean Arbitration Act ("Act") contains many of the same provisions as the UNCITRAL Model Law and the New York Convention. Thus, the Act requires that an arbitration agreement be in writing and signed by the parties. Other than this requirement, there are no other formal requirements for an enforceable arbitration agreement under the Act.

The parties are free to agree on a procedure to appoint arbitrators. If the agreement is silent as to the number of arbitrators, the Act provides for three arbitrators. If the parties have agreed to have a sole arbitrator but are unable to agree upon an arbitrator within 30 days of a request to initiate the appointment procedures, the arbitrator will be appointed by the court at the request of either party. If the parties have agreed to three arbitrators (or not agreed on the number of arbitrators), each party appoints one arbitrator, and the two party-appointed arbitrators will appoint the third. If either party fails to appoint a third arbitrator within 30 days of their appointment, the court will appoint the arbitrator upon the request of either party.

The parties are also free to agree upon the arbitration process. However, there are certain mandatory requirements, including the following: (1) the tribunal may request assistance from the courts for the purpose of taking evidence and (2) the tribunal may terminate the arbitral proceedings if the parties reach a settlement, but may record the settlement in the form of an award if so requested by the parties.

The losing party in an arbitration may file an application with a relevant court to set aside the award. However, there is no procedure to request a Korean court to set aside a foreign arbitral award.

Both domestic and foreign arbitral awards are enforced by a Korean court judgment. The procedural requirements for an enforcement action are minimal. A party applying for the recognition or enforcement of an award must submit to the court the duly authenticated original or a certified copy of the award, the arbitration agreement, and a duly certified Korean translation of the award, if not already in the Korean language.

Foreign arbitral awards subject to the New York Convention are readily recognized and enforced while awards from other jurisdictions are recognized and enforced in the same manner as foreign court judgments.

The enforceability of foreign court judgments can be difficult and time consuming since the local court will examine various aspects of the foreign judgment to ensure that it meets the requirements of local practice. In contrast, both domestic and foreign arbitral awards are much more straightforward to enforce because Korean courts take a friendly attitude toward arbitration, and Korea is a signatory to the New York Convention.

In addition to arbitration, ADR may be pursued through court-appointed mediation. Such mediation is governed by the Judicial Conciliation of Civil Disputes Act, and is conducted either by a single judge or a media-

tion committee composed of lay persons who are industry experts. While court-supervised mediations are strongly encouraged by the courts, there is no statutory requirement that a party enter into mediation or attempt to resolve a dispute prior to commencing litigation or arbitration in Korea.

III. Concluding Remarks

Traditionally, parties to an agreement have chosen a dispute resolution provision that provides for arbitration over litigation on the premise that arbitration leads to a quicker and less costly decision. When compared to U.S. litigation, these advantages are evident. However, they appear to be less compelling when compared to litigation in Korea. Litigation in Korea tends to be a straightforward process and, hence, quicker and less expensive than in the U.S. The fact that the courts still prefer to evaluate a case mostly on the pleadings, and the absence of vigorous discovery, among other things, may or may not be advantageous, and are therefore factors to consider. Other factors include the level of trust and familiarity with the Korean courts, the level of trust and familiarity with the arbitration process, the costs of arbitration, i.e., the arbitrators, the potential need to enforce an arbitrator's decision in Korea and the costs of same, the costs of possibly defending against the setting aside of a domestic arbitral award, etc.

If arbitration is the desired dispute resolution forum, foreign arbitration (as opposed to domestic) arbitration may hold advantages for U.S. parties since there may be less chance of national bias and language issues, and, as mentioned before, foreign arbitral awards subject to the New York Convention may not be set aside by a Korean court and are readily enforceable.

Whichever forum you decide upon—whether the courts or arbitration—should produce a decision that is based on the legal merits presented. The key is determining which will provide you with the best chances for success in the most efficient and economical manner possible.

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New Decision Highlights the Importance of Forum Selection Clauses in Cross-Border Employment Agreements

By Philip M. Berkowitz

Multinational employers often negotiate, with their key employees, employment agreements and restrictive covenants that prohibit unfair competition across borders. To prevent inconsistent judgments and give the parties a firmer expectation regarding their rights, many employers negotiate choice-of-law and choice-of-forum provisions that select one jurisdiction's laws or forum over another's.

The enforceability of these provisions in the United States was recently affirmed by the U.S. District Court for the Southern District of New York in *Martinez v. Bloomberg LP*, 2012 U.S. Dist. LEXIS 113227 (S.D.N.Y. Aug. 10, 2012). This decision holds important lessons for multinational employers concerning the enforceability and limitations of these clauses.

The lawsuit was filed by a former employee who was initially hired by Bloomberg in New York, spent three years in Tokyo, and was then transferred to the London office. In London, he entered into a new employment agreement that designated London as his primary place of business, provided that English law would govern his employment, and that "any dispute arising hereunder shall be subject to the exclusive jurisdiction of the English courts."

In 2011, the employee lost his job in a workforce reduction. He sued the company in New York federal court, alleging employment discrimination under the U.S. Americans with Disabilities Act, as well as New York State and New York City anti-discrimination laws.

Three days after filing suit in New York, the former employee sued in England under English employment law. He did not assert any claims for discrimination before the English tribunal, and later withdrew his action there, citing the high cost of litigating in England. The employer moved to dismiss the New York action for improper venue based on the forum selection clause, and also moved to dismiss the state and city law claims for lack of jurisdiction.[1]

While the former employee did not dispute that the choice-of-forum clause was reasonably communicated to him and was "mandatory," he argued that the clause was not meant to bar statutory claims, but, by virtue of the clause's express language ("any dispute arising *hereunder*"), only claims that related to the employment contract *per se*. He asserted that the discrimination claims could go forward despite the language of the agreement because those claims were statutory, not contractual.

This argument might have passed muster under New York law. As the court noted, a clause mandating arbitration of "any claims arising under [the Employment] Agreement" has been held not to be specific enough to include claims of statutory discrimination.[2] Such language failed to fairly notify the employee that statutory discrimination claims were also subject to arbitration or to other limitations.

However, the court held that the contract's choice-of-law clause mandated that English law governed interpretation of the forum selection clause. And unlike in the United States, claims of discrimination in England may *only* be brought if the employment relationship is predicated upon the existence of a valid contract. As a result, the discrimination claim technically arose "under the agreement" because without the contract, under English law, there could be no claim for discrimination. In addition, English law broadly interprets choice of forum clauses, and the words "arising out of" have been interpreted to include *every* dispute except a dispute as to whether there was a contract at all. As a result, the court held that the forum selection clause, under English law, included discrimination claims, and enforced the forum selection clause and dismissed the lawsuit.

Prior to the *Martinez* decision, the U.S. Supreme Court had upheld and reinforced the "strong federal policy in favor of enforcing forum selection clauses." Enforcing these clauses "removes uncertainty" in economic transactions, ensures that the parties' expectations are fulfilled, and complies with the dictates of international comity to respect the integrity and competence of the selected foreign tribunals.[3]

Generally, a forum selection clause will be enforced if it was reasonably communicated to the party resisting enforcement, it is mandatory and not merely permissive, and the claims involved in the suit are subject to the clause. If these requirements are met, then the burden shifts to the non-moving party to rebut the presumption of enforceability by showing that the clause was the result of fraud or overreaching; the law to be applied in the selected forum is fundamentally unfair; enforcement would contravene a strong public policy of the forum state; or trial in the selected forum would be so difficult and inconvenient that

the party would effectively be deprived of his or her day in court.[4]

Critically, the court in *Martinez* concluded that the employee was a "sophisticated international businessman." Therefore, the court declined to be bound by English cases that could be construed to protect the rights of laborers in an employment dispute from an unfavorable forum selection (or mandatory arbitration) clause. The court considered the agreement to be more in the nature of a commercial contract between parties with equal bargaining power. Thus, the validity of the choice of forum clause did not depend on whether the law of the selected forum was less favorable to the plaintiff.

Martinez is, somewhat ironically, consistent with the holding of a well-known English restrictive covenant case that declined to enforce a New York choice of forum clause against employees working in London. In *Samengo-Turner v. J & H Marsh & McLennan (Services) Ltd*,.[5] an English Court of Appeal refused to give effect to a restrictive covenant's New York jurisdiction clause, where the London-based employees were employed by an English company that belonged to a group of companies headquartered in New York. The brokers had applied to the English court for an anti-suit injunction to stop proceedings that had been initiated in the Southern District of New York.

In Europe, the issue of forum selection is a matter of statute, and employers may only sue the employees where they are domiciled. U.S. employers have more flexibility, but a court in which an employee is domiciled could well determine that it has a superior interest in hearing a matter than does a remote jurisdiction with which the employee has had little or no contact, particularly if the law of that jurisdiction would contravene the public policy of the employee's domicile state.

Forum selection clauses, if properly drafted, can be helpful to employers. They should be drafted broadly enough to cover any and all claims, including statutory claims like discrimination, and not just contractual ones. The clauses should also use mandatory, not permissive language. The agreement should provide that the exclusive jurisdiction and law *shall be* (rather than *may be)* the city of, *e.g.*, New York, New York. And finally, common sense dictates that if the employee is to be assigned to a non-English speaking jurisdiction, the employer should consider having the employee sign a translated copy of the agreement in the language of the assignment country.

Endnotes

1. The former employee theoretically (absent the English choice-of-law clause) could assert claims under the Americans with Disabilities Act for alleged overseas discrimination because that law prohibits extraterritorial discrimination by U.S. companies against U.S. citizens, regardless of where they work and reside. However, claims under the New York State and New York City laws for alleged overseas discrimination against non-residents may only go forward where the plaintiff can show that the alleged discrimination had an impact in New York. *See Hoffman v. Parade Publications*, 2010 N.Y. Slip Op. 05706 (July 1, 2009).
2. *See, e.g., Cronas v. Willis Group Holdings Ltd.*, 2007 U.S. Dist. LEXIS 68797 (S.D.N.Y. Sept. 17, 2007) (the court's analysis repeatedly draws parallels between mandatory arbitration and forum selection clauses).
3. *Martinez*, at *9 (citing *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991); *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972); *Aguas Lenders Recovery Grp., LLC v. Suez, S.A.*, 585 F.3d 696 (2d Cir. 2009); *Roby v. Corp. of Lloyd's*, 996 F.2d 1353 (2d Cir. 1993).
4. *Phillips v. Audio Active, Ltd.*, 494 F.3d 378 (2d Cir. 2007).
5. [2007] EWCA Civ 723.

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Drafting Dispute Resolution Clauses Involving Australian Parties—What U.S. Corporate Counsel Should Consider

By Henry Winter and David Mason

Where a U.S. based company is engaged in business within Australia, or with an Australian-based company, without an agreement as to the appropriate jurisdiction for dispute resolution, it may find itself subject to the jurisdiction of an Australian court.[1] In this event, the U.S. company may be compelled to participate in Australian proceedings. To mitigate this risk, U.S. corporate counsel should consider incorporating an exclusive or non-exclusive jurisdiction clause, a choice of law clause or an arbitration clause into their contracts.

1. Agreements to Establish Jurisdiction

Important points for U.S. corporate counsel to note are that in Australian contracts the choice of jurisdiction must be specified at the time of execution of the contract and cannot be left to be nominated at a later date. There is also no requirement for a factual connection between Australia and the country whose legal system has been nominated to govern the contract. Furthermore, an Australian court will not give effect to a choice of law clause that is designed to evade a law that would otherwise apply, if that is a law of the forum.[2]

1.1 Types of clauses

Australian courts will generally hold parties to an exclusive jurisdiction clause either by staying Australian proceedings or issuing an anti-suit injunction against foreign proceedings.[3] An Australian court can, however, refuse to do so where there are "strong reasons"[4] not to enforce the clause, such as where a party is seeking statutory relief that is only available in one jurisdiction,[5] or where there is considerable inconvenience or expense caused to third parties.[6] A stronger connection with another jurisdiction does not of itself constitute a strong reason[7] and general principles of *forum non conveniens* will not be considered relevant to the enforcement of an exclusive jurisdiction clause in Australia.[8]

The enforcement of a non-exclusive jurisdiction clause will, however, be determined by the principles of *forum non conveniens* which, in Australia, requires the party disputing jurisdiction to establish that a chosen forum is the "clearly inappropriate forum"[9] for the dispute, as compared to the test applied in the United Kingdom of the "more appropriate" forum.[10]

Australian courts will not interpret a choice of law clause as having any binding effect on the choice of forum for a dispute and will not, absent evidence to the contrary, imply a jurisdiction clause.[11] However, a choice of law clause may be considered as a factor in determining whether a particular jurisdiction is clearly inappropriate.

1.2 Drafting jurisdiction clauses

The consequences of imprecise or ambiguous drafting of jurisdiction clauses can be significant. For example, if a jurisdiction clause conferring jurisdiction on a U.S. court is interpreted to be non-exclusive, the U.S. based party can still be bound to the jurisdiction of Australian courts unless the Australian court can be demonstrated as being the "clearly inappropriate" forum. Therefore, precision in drafting of such clauses is paramount. The inclusion or omission of the word "exclusive" is an important first step but will not always be conclusive. The following general points of interpretation can be drawn from recent Australian authorities:[12]

- The interpretation of a jurisdiction clause is a matter of construction and must be considered in light of all the surrounding circumstances;
- Where the selected forum is also the natural forum for the dispute, the clause will tend to be exclusive;
- Where the language used in the jurisdiction clause, or the nature of the contract itself, lead towards a contractual intention they may be considered in constructing the term;
- In the case of ambiguity a clause may be interpreted in favor of the party to whom the benefit of the clause was directed; and
- The use of mandatory and inclusive language such as "all" or "any" disputes will tend toward the clause being considered exclusive.

1.3 Model jurisdiction clause

Using the points above, the following model clause can be constructed:

> *This Contract is to be governed by and construed in accordance with the laws of the State of New York, United States of America. In relation to all disputes arising out of or in relation to this contract, the parties agree to hereby submit themselves to the exclusive jurisdiction of the courts of that State.*

The above clause will be capable of the widest possible construction under Australian law by using the phrase "arising out of or in relation to." Furthermore, while there

is a tendency for corporate counsel to treat jurisdiction clauses as standard precedent, it is important that contracting parties consider the precise construction of jurisdiction clauses in the particular circumstances of the contract to minimise the risk of foreign litigation, as opposed to the insertion of standard "boilerplate" clauses.

2. Enforcing Judgments in Australia

Judgments issued in Australian courts can be routinely registered in any Australian jurisdiction under the *Service and Execution of Processes Act 1992* (Cth) (**SEPA**) and enforced as if it were a judgment of that jurisdiction, allowing the judgment to be enforced anywhere in Australia.

In cases where a jurisdiction clause deprives Australian courts of jurisdiction, U.S.-based companies should ensure that the order of a U.S.-based or other foreign court be enforceable against Australian counterparts. The enforcement of foreign judgments, however, will depend on which jurisdiction the judgment is issued in and the nature of the judgment itself.

2.1 Statutory registration

Registration under the *Foreign Judgments Act 1991* (Cth) (**FJA**) is the most efficient method of enforcing a foreign judgment in an Australian jurisdiction. A party can apply for registration where the judgment is monetary and was issued by a court specified in the regulations as similarly recognizing Australian judgments, such as the United Kingdom or Canada.[13] Judgments of U.S. courts, however, are not registrable under the FJA[14] and any U.S.-based party seeking to enforce a U.S. foreign judgment cannot rely on registration.

In order to register a judgment under the FJA, the judgment creditor must make an application to the most appropriate court in an Australian jurisdiction to provide the enforcement required, and the court will register the judgment unless it has been wholly satisfied or if the issuing court can enforce the order itself. Once registered, judgment debtors may apply to set aside the registration or stay any subsequent enforcement if they intend to appeal the original foreign judgment. Once a judgment is successfully registered it will be enforceable as if it were a judgment of the registering court.

2.2 Common law enforcement or recognition

Common law recognition is an alternative mechanism where the foreign judgment is monetary but cannot be registered by statute. Parties can look to the common law to enforce foreign judgments where the FJA does not apply,[15] and it is the main mechanism by which U.S. judgments are enforced in Australia.

Common law enforcement can be done in two ways: by enforcement (bringing an action for debt under the foreign judgment); or by recognition (commencing fresh proceedings in an Australian court and relying on the foreign judgment in issue estoppel to bar the judgment debtor from raising any defense that was, or could have been, run in the foreign court). The practical difference between these options, however, appears to be minimal and most recent authorities simply refer to the action as an application for the enforcement of a foreign judgment.

The foreign judgment must meet a number of criteria to be enforced or recognized in an Australian court:

(a) The foreign court must have been validly exercising jurisdiction over the Plaintiff at the time the judgment order was made,[16] in accordance with Australian private international law.[17] This can be established, for example, where the Plaintiff was present in the jurisdiction,[18] voluntarily submitted to the jurisdiction of the foreign court[19] or agreed prior to the action to be bound by the jurisdiction of the foreign court;

(b) The judgment sought to be enforced or recognized must be final and conclusive in accordance with the law of the foreign jurisdiction. For example, the judgment cannot be a merely procedural order, but the fact that a judgment is subject to an appeal does not mean that an Australian court will consider it to be not final or conclusive;[20]

(c) The judgment must have been made for a fixed or readily calculable monetary sum that cannot constitute a payment of a penalty or revenue-related debt; and

(d) The parties must be identical to those in the foreign proceedings and must be acting in the same capacity.[21]

An Australian court may, however, exercise its discretion not to enforce or recognize a judgment satisfying the above criteria where: (1) to do so would be against public policy;[22] (2) the judgment creditor was not afforded natural justice in the foreign forum;[23] (3) the judgment was obtained by fraud;[24] or (4) where such recognition is barred by an applicable Australian statute.[25]

Once an Australian court orders that the foreign judgment be recognized, the judgment of the Australian court may then be registered pursuant to the SEPA, and will then be enforceable in all Australian jurisdictions.[26]

2.3 Equitable recognition

Equity may also recognize a foreign judgment not enforceable under statute or common law, such as a non-monetary judgment in the form of an injunction. This point of law remains unsettled and academic commentary adopts the position that equity cannot be used to enforce a non-monetary judgment;[27] however, recent authority suggests otherwise.[28] Therefore, where a U.S.-based party

is dealing with an Australian-based party it is important to consider the enforceability of any judgment against that Australian party should a dispute arise. For example, where the parties are subject to a valid exclusive jurisdiction clause giving jurisdiction to a U.S. court, the U.S. based party may not be able to enforce a non-monetary injunction granted by a U.S. court against the corresponding Australian party. They may also be barred, by virtue of the jurisdiction clause, from bringing an action for an injunction in an Australian court. As such, the parties should turn their minds to the ambit of possible disputes at the early stages of negotiating a contract and should ensure that the parties' interests can be appropriately protected.

3. Commercial Arbitration in Australia

U.S. based corporate counsel should also consider adopting an arbitration clause in their contracts. Australia has a long-standing tradition of embracing arbitration as a means of alternative dispute resolution. On a domestic level this is reflected by court-sanctioned and compulsory arbitration prescribed for certain disputes. Arbitration has also become equally common in international disputes. Amendments to the *International Arbitration Act* 1974 (Cth) (**IAA**) and the introduction of new Commercial Arbitration Acts (**CAAs**) for the Australian states have ensured Australia remains at the forefront of global arbitral practice.

The 2010 amendments to the IAA introduced a number of significant changes.[29] Most importantly, the 2006 Model Law replaced the 1985 version as the applicable law under the IAA.[30] The IAA now also contains several provisions which are unique to Australia and supplement the Model Law. Division 3 contains provisions which apply unless the parties expressly opt-out, such as provisions on the parties' right to obtain subpoenas requiring a person to produce certain documents or attend to examination before the arbitral tribunal.[31] Furthermore, there are other provisions which only apply if the parties opt-in, such as provisions dealing with confidentiality[32] or the consolidation of proceedings.[33]

3.1 Institutional arbitration in Australia

The Australian Centre for International Commercial Arbitration (ACICA) is Australia's premier international arbitration institution and is at the forefront of international best practice. It has two sets of procedural rules: the ACICA Arbitration Rules and the Expedited Arbitration Rules.[34] ACICA is also the prescribed authority to appoint arbitrators under the IAA.[35]

The ACICA Rules contain a set of "Emergency Arbitrator" provisions,[36] which enable the appointment of an "Emergency Arbitrator" in arbitrations that have commenced under the ACICA Rules but have not yet had a tribunal appointed. As a consequence of accepting ACICA arbitration, parties not only accept arbitration according to the ACICA Rules, but also agree to be bound by the emergency rules and any decision of an Emergency Arbitrator.[37]

The ACICA Rules also contain provisions for "Application for Emergency Interim Measures of Protection."[38] These provisions provide that the Emergency Arbitrator may grant any interim measures of protection on an emergency basis that the Emergency Arbitrator deems necessary and on such terms as the Emergency Arbitrator deems appropriate.[39]

3.2 Arbitration agreements

For international arbitrations in Australia, arbitration agreements are to be in writing. Under the IAA, the term "agreement in writing" includes an arbitration clause in a contract or an arbitration agreement signed by both parties or contained in the exchange of letters.[40]

The CAAs provide that for domestic arbitrations an arbitration agreement can be evidenced through electronic communication or in a statement of claim or defense, or incorporated by reference in a contract to any other document containing an arbitration clause.

The Federal Court has also confirmed that an arbitration clause contained in an exchange of signed letters is sufficient to fulfill writing requirement.[41]

3.2 Model arbitration clause

The ACICA Model Arbitration Clause is as follows:

> *Any dispute, controversy or claim arising out of, relating to or in connection with this contract, including any question regarding its existence, validity or termination, shall be resolved by arbitration in accordance with the ACICA Arbitration Rules. The seat of arbitration shall be Sydney, Australia* [or choose another city]. *The language of the arbitration shall be English* [or choose another language]. *The number of arbitrators shall be one* [or three, or delete this sentence and rely on Article 8 of the ACICA Arbitration Rules].

U.S.-based corporate counsel should note that in this clause, if no contrary election is made, the arbitration will be subject to Australian law; namely, the IAA. This clause is also drafted to ensure that pre-contractual disputes such as allegations of misrepresentation, misleading or deceptive conduct in pre-contractual negotiations and statutory torts relating to the contract, are capable of settlement by ACICA Rules arbitration.

The ACICA Model Arbitration Clause is also suitable for both domestic and international arbitrations.

4. Enforcement of Arbitral Awards in Australia

Australia has acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards without reservation. Section 8 of the IAA implements Australia's obligations under Article V of the New York Convention and provides for foreign awards to be enforced in the courts of a state or territory, or in the Federal Court, as if the award were a judgment or order of that court. Section 8 of the IAA only applies to awards made outside Australia. For awards made within Australia, either article 25 of the Model Law for international arbitration awards, or section 35 of the CAAs, applies.

The Federal Court has also recently reinforced the finality of arbitral awards and Australia's pro-enforcement policy by holding that there is no general discretion to refuse enforcement, and that the public policy ground for refusing enforcement should be interpreted narrowly and not give rise to any sort of residual discretion.[42]

Endnotes

1. The Australian judicial system is federal in nature, with a hierarchy of Commonwealth courts with the federal jurisdiction granted to it by legislation, and independent State and Territory court hierarchies based primarily on territorial jurisdiction, with all courts in Australia inferior to the High Court of Australia.
2. *Akai Pty Ltd v. The People's Insurance Co* (1996) 188 CLR 418; *Commonwealth Bank of Australia v. White* [1999] 2 VR 681, [11].
3. *CSR Ltd v. Cigna Insurance Australia Ltd* (1997) 189 CLR 345.
4. *Oceanic Sun Line Special Shipping Co Inc v. Fay* (1988) 165 CLR 197, 259 (per Gaudron J); *Akai Pty Ltd v. The People's Insurance Co* (1996) 188 CLR 418, 429 (per Dawson and McHugh JJ) and 445 (per Toohey, Gaudron and Gummow JJ).
5. *Commonwealth Bank of Australia v. White (No 4)* [2001] VSC 511.
6. Ibid.
7. *Akai Pty Ltd v. The People's Insurance Co* (1996) 188 CLR 418.
8. *Oceanic Sun Line Special Shipping Co Inc v. Fay* (1988) 165 CLR 197, 230-231 (per Brennan J).
9. *Voth v. Manildra Flour Mills Pty Ltd* (1990) 171 CLR 538, 570-571.
10. See *Voth* [1987] 1 AC 460; cf *Spiliadia Maritime Corporation v. Cansulex Ltd* [1987] 1 AC 460.
11. *Ace Insurance Ltd v. Moose Enterprise Pty Ltd* [2009] NSWSC 724, [72].
12. See *Ace Insurance Ltd v. Moose Enterprise Pty Ltd* [2009] NSWSC 724, [32]-[33]. See also: *FAI General Insurance Co Ltd v. Ocean Marine Mutual Protection and Indemnity Association* (1997) 41 NSWLR 117, 126-127.
13. For a full list of jurisdictions to which the Act applies, see: *Foreign Judgment Regulations 1992* (Cth), s. 5 and Schedule 1.
14. See: *Foreign Judgment Regulations 1992* (Cth) s Schedule 1.
15. If the FJA does apply a party cannot seek enforcement or recognition under the common law. See: *Foreign Judgments Act 1992* (Cth), s. 10.
16. *Singh v. Rajah of Faridkote* [1894] AC 670.
17. For natural persons, see *Harris v. Harris* [1947] ALR 106. For bodies corporate, see *Adams v. Cape Industries Plc* [1990] Ch 433; *Vogel v. R and A Kohnstamm Ltd* [1973] QB 133.
18. *Herman v. Meallin* (1891) 8 WN (NSW) 38.
19. *Malaysia-Singapore Airlines Ltd v. Parker* (1972) 3 SASR 300; *Re Williams* (1904) 2 N & S 183. A party may appear to refute the jurisdiction of the court or to defend property rights without being considered to have submitted to the jurisdiction of the foreign court: *Foreign Judgments Act 1992* (Cth) s 11.
20. *Funge Systems Inc v. Newcom Technologies Pty Ltd* [2005] SASC 498, [47].
21. *Blohn v. Desser* [1962] 2 QB 116.
22. *Bank Polska Kasa Opieki Spolka Akcyjna v. Richard Zbigniew Opara* [2010] QSC 93.
23. *Boele v. Norsemeter Holding AS* [2002] NSWCA 363, [24].
24. *Allardyce Lumber Company Limited v. Quarter Enterprises Pty Ltd (No 2)* [2012] NSWSC 438.
25. *Foreign Judgments Act 1992* (Cth) s 10.
26. *Re Cryonic Medical* [2002] VSC 338, [10].
27. See: Kim Pham, "Enforcement of Non-Monetary Foreign Judgments in Australia" (2008) 30 *Sydney Law Review* 663, 666. See also, *Jackman v. Broadbent* [1931] SASR 82.
28. *White v. Verkouille* [1990] 2 Qd R 191 and *Independent Trustee Service Ltd v. Morris* [2010] NSWSC 1218.
29. A comprehensive discussion of the amendments to the International Arbitration Act is beyond the scope of this paper. For a concise overview see: Jones, D. "Australia" published in the *Asia-Pacific Arbitration Review 2013*, published by Global Arbitration Review, pp 21-29. For a detailed examination see: Holmes, M and Brown, C, *The International Arbitration Act 1974: A Commentary*, LexisNexis Butterworths (2011).
30. The 2006 Model Law is given the force of law in Australia pursuant to section 16 of the IAA.
31. Section 23, IAA.
32. Section 23C, IAA.
33. Section 24, IAA.
34. ACICA have adopted an opt-in approach for the Expedited Arbitration Rules, requiring parties to explicitly select them (rather than the ACICA Rules) in their arbitration agreement.
35. See ACICA Appointment of Arbitrators Rules 2011, adopted by ACICA on 2 March 2011, available at www.acica.org.au (Accessed 13 September 2012).
36. ACIA Rules, schedule 2.
37. The power of the Emergency Arbitrator applies to all arbitrations conducted under the ACICA Rules, unless the parties expressly opt out of it in writing.
38. ACIA Rules, schedule 2.
39. These emergency procedures do not, however, prejudice a party's right to apply to any competent court for interim measures.
40. Article 7, Model Law.
41. *Comandante Marine Corp v. Pan Australia Shipping* [2006] FCAFC 192.
42. *Uganda Telecom Pty Ltd v. Hi Tech Telecom Pty Ltd* [2011] FCA 131.

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Dispute Resolution/Forum Selection Clauses—What Corporate Counsel Should Keep in Mind

By Clifford J. Hendel and Elena Sevila

Dispute resolution clauses, though often deceptively short, merit great care in their drafting. Taking the time and making the effort to negotiate a dispute resolution clause may avoid engaging in costly and time-consuming proceedings. However, parties often fail to dedicate sufficient attention to these clauses until disputes actually arise, which is often "too late" to establish a fair and balanced clause, and which invites costly and unnecessary delay in bringing the matter to conclusion.

This article will investigate the main considerations corporate counsel should consider when negotiating the dispute resolution clause of an agreement when their client or project is overseas.

Pre-Judicial or Pre-Arbitral Resolution Mechanisms

When referring to a "dispute resolution clause" one may be tempted to automatically assume that reference is made to a national court, or to an arbitral forum, to which the parties will submit any potential controversy. However, we often forget that several alternative dispute resolution mechanisms are available and that the number of contracts including such mechanisms is increasing.

Direct negotiation and mediation are perhaps the most popular alternative dispute resolution mechanisms included in dispute resolution clauses. Negotiation, of course, is a process by which parties to a dispute communicate and exchange proposals in an attempt to resolve the same on a consensual basis. Mediation in many ways is an extension of negotiation where the parties to a dispute seek the assistance of a party not directly involved in the conflict to resolve their differences without having recourse to a binding third-party decision having the force of law and issued by a judge or arbitrator.

Alternative dispute resolution mechanisms, when they work, are obviously more effective and efficient than costly, time-consuming and debilitating court or arbitral proceedings. Such alternative mechanisms are especially suitable where a dispute occurs between parties valuing the preservation of their commercial relationship. However, there are a few things to keep in mind when drafting negotiation or mediation clauses, especially when these alternative mechanisms are considered as a prior step or condition to the initiation of judicial or arbitral proceedings.

First of all, the clause should clearly state whether the recourse to negotiation (i.e., meeting of senior executives to negotiate a settlement) and/or mediation is considered as a binding condition to initiating the proceedings. Otherwise, ordinary courts will be obliged to decide whether the parties were bound to negotiate in good faith or to mediate should a conflict arise. This may result in delay and extra expenses.

Secondly, parties have to determine when the condition is fulfilled, that is to say, when the negotiation or mediation requirement has been satisfied (freeing the parties to bring a judicial or arbitral claim). It is generally helpful to establish a limited time period after which, absent agreement to extend the period, these alternative proceedings would be deemed to be concluded and formal actions could be commenced.

Finally, there are cases where seeking a court (or arbitral) order providing interim relief may be crucial for one of the parties, and the existence of a negotiation/mediation clause may become a problem for the competent body that has to award it. Therefore, when drafting a dispute resolution clause, exceptions permitting the parties to seek these extraordinary measures (in spite of the binding mediation or negotiation) have to be included, or the time limitations for the consensual process have to be very brief.

"Home Court Advantages"

Obviously negotiation and mediation mechanisms do not always bear fruit. And clients and their counsel often are dubious of such procedures, and reluctant to commit to use them. (It should be remembered that in many jurisdictions worldwide, there is very little in the way of mediation or negotiation "culture," and players from such jurisdictions often will have little faith and no experience in the process.) Thus, parties are often obliged to resort to the national courts. When litigation becomes necessary, one of the first questions to be asked is where suit should be filed.

On a preliminary basis at least, the most favourable situation for a party to a dispute involving an international commercial transaction is to litigate in one's own courts. Even if the courts of the counterparty's country are viewed as unbiased, that party is litigating at home, using its regular lawyers following a familiar procedure and its own language.

Litigating in a foreign country always entails inconveniencies (unknown procedural rules, in some cases a different language, ignorance of other factors that could

have an important impact on the outcome of the case) and extra expense.

Recourse to "home court" litigation renders the foreign party subject, of course, to all procedures common in the home country: if your client is foreign, you will generally want to avoid exposing him to U.S.-style discovery and deposition practice, which will be entirely alien to him.

Thus, in international transactions, typically the counterparty does not agree to litigate before your courts, just as you may not agree to litigate before his.

In this regard, it should be remembered that certain contractual matters may not be adjudicated by courts notwithstanding the choice made in the dispute resolution clause, since in respect of such matters a particular court has exclusive power of decision. This exclusive jurisdiction of a particular court derives from the substantive law of the contract. Thus, together with the forum selection clause, it is important to establish the law that ensures the adjudication of the matter case by the preferred court.

Importantly, it should also be remembered that in any event recourse to "home court" may not in the end be particularly useful in terms of enforceability of the judgment. When no agreement exists between the country where the judgment has been issued and the country where it has to be executed (for instance, the place where the assets of the defendant are located) this judgment could be useless; and even where such an agreement exists, actual enforcement could be time-consuming and expensive, at a minimum. It is thus highly recommended to take the time and make the effort to analyze whether the judgment of our own court will be easily enforced in the country or countries where the other party's sizable assets are located.

Arbitration: The Most Suitable Option

Thus, there are many cases (surely the majority of international transactions) where the designation of one's own court is impossible or imprudent. Arbitration becomes the preferred option in these circumstances, as it is perceived to level the playing field between the parties, leaving it to them to establish the procedure that will govern the proceeding, to choose the arbitrator or arbitrators who will decide it, and otherwise leave decision control to the fullest extent possible in the hands of the parties; certain additional benefits or perceived benefits of arbitration include increased confidentiality, faster and better adjudication, etc.

Furthermore, in terms of enforceability, arbitration is the preferred efficient dispute resolution mechanism since the Convention on Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention (the "Guardianship" of which has been declared by the NYSBA International Section as one of its three missions) ensures on a nearly worldwide basis the enforcement (without substantive review of the merits) of arbitral awards issued in a jurisdiction which is party.

Unfortunately, an arbitration clause does not automatically guarantee all the benefits of arbitration (speed of proceedings, confidentiality, and certainty of forum...) and an ill-drafted clause may have results more detrimental than advantageous.

By appointing an arbitral institution and by including the model arbitration clauses proposed by such institution in their contract, parties are off to a good start insofar as the configuration of their arbitral process is concerned.

When parties decide to complete or fine-tune these model arbitration clauses), special care should be taken. Otherwise, the risk exists of drafting clauses in such a way that they may lead to disputes over their interpretation that may result, at best, in unnecessary delay and expense and, at worst, in the nullity of the arbitration clause (the so called pathological clauses).

In this regard, parties should avoid appointing a specific person who may refuse or be unavailable to act when the time comes. Also, parties should avoid too much specificity with respect to the qualifications of the arbitrator or impossible deadlines to render the award. Special attention should be paid not to misname or invent the institution appointed.

The more complete an arbitration clause is the more chances the parties have to obtain a satisfactory resolution to their dispute. Counsel may want to consult in this regard the International Bar Association's *Guidelines for Drafting International Arbitration Clauses*, with recommended clauses for optional elements such as provisional and conservatory measures (the authority of the arbitral tribunal and of the courts), document production, confidentiality, allocation of costs and fees, qualifications required of arbitrators, time limits, finality. Also multi-tier, multi-party and multi-contract dispute resolution clauses models were suggested. Another classic in the area is Paul Friedman's text *Drafting Arbitration Clauses*.

In conclusion, while the dispute resolution / forum clause of an agreement may be the least of your concerns when negotiating the document, it may turn out to be of critical concern if and when a dispute arises. At that point, you (and your client) will be very thankful for the care and attention that you may have devoted to it before the ink was dry on the agreement.

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Defining and Re-Defining Due Diligence: In Search of a Standard

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The concept of due diligence has dramatically evolved in the wake of the Sarbanes Oxley Act and Dodd Frank Act. Tightly woven throughout the securities laws, due diligence seems to have unraveled into ambiguity. Its traditional role as a defense has also come under siege. This recent trend cuts against the longstanding knowledge or knowing participation doctrines for third parties. It also ignores that in finely tuned regulatory statutes, there still remain defenses available to those who can show they had no knowledge of any wrongdoing and, even with reasonable inquiry, could not have discovered the plans of scheming fraudsters. In short, the desire for revenge against "somebody" is untying securities law from its moorings. The consequences may be awful. A recent study by the Society of Corporate Compliance and Ethics has revealed that compliance professionals are experiencing a significant amount of job-related stress from "figuring how to comply with new and changing laws and regulations."[1] Compliance departments' shrinking resources further limit their ability to keep pace with these shifting standards as they strive to stay strong in conducting due diligence and in backing out of contracts when red flags arise.[2] Fifty-eight percent of nearly one thousand compliance professionals surveyed reported that they often wake up in the middle of the night from such stress, while sixty percent reported that they have actually considered leaving their job during the last year due to the great amount of stress.[3] The rapid evolution of this already vague standard reflects the overall protogenetic nature of what we are now calling "law" in this area.

I. Regulatory Landscape

The due diligence standard plays a prominent role in the statutory framework of securities law. Section 11 of the 1933 Securities Act imposes liability "in case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading" on "every underwriter with respect to such security."[4] Whether a statement or omission is "material" is a question of fact based on whether a "reasonable investor" would find the information significant.[5] As Milton H. Cohen, former director of the Special Study of Securities Markets in the early 1960s, wrote, "the liability provisions have had the in terrorem effect of creating an extraordinarily high sense of care and responsibility in the preparation of registration statements."[6] Section 12(a)(2) imposes liability on "any person who offers or sells a security…by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements…not misleading."[7]

Sections 11 and 12 both set forth a "due diligence" defense under which a defendant can avoid liability where he or she either conducted a reasonable investigation into registration statement materials or reasonably relied on an expert's opinion. To invoke this defense, Section 11 requires a party to prove that after conducting a reasonable investigation, the party had reasonable grounds to believe and did believe that the statements were true and that there were no omissions.[8] Likewise, Section 12 requires that a party show he or she did not know, and in the exercise of reasonable care, could not have known, of the falsehood or omission. Courts apply the "reasonable investigation" standard of Section 11 and "reasonable care" standard of Section 12 in the same way, and recognize that the standard of care is that of a "prudent man."[9] Thus, a robust body of case law has recognized due diligence as essentially a negligence standard.[10]

In contrast, the 1934 Exchange Act applies a higher standard for determining liability for fraud through Section 10(b) and Rule 10(b)-5. More specifically, section 10(b) imposes liability for using or employing "in connection with the purchase or sale of any security…any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe…."[11] To establish fraud under Section 10(b), a plaintiff must show that the defendant made a misstatement or omission of material fact[12] *with scienter*,[13] which the plaintiff relied upon[14] and proximately caused his or her injury.[15] The SEC and courts in a number of areas have held that notions such as "reasonableness" or "red flags" sufficed to satisfy the *scienter* standards found in many statutes. However, the recent Supreme Court decision in *Global-Tech Apliances, Inc. v. SEB S.A.* seemingly has cut back on the ill-defined, and often pernicious and amorphous concept.[16] Indeed, "[i]f we desire respect for the law, we must first make the law respectable."[17]

Section 20 of the Exchange Act imposes liability on control persons, and contains an affirmative defense under which a control person who acted in good faith and did not "directly or indirectly induce" or cause the violation may escape liability. "Control person" could include parties who took no part in the activity constituting the underlying violation. This defense prevents courts from

finding a control person liable if he or she did not engage in the violative conduct. Such a person would, in theory, lack the required scienter. Under this framework, both primary and secondary actors can raise due diligence as a defense to escape liability. A primary alleged violator may argue that despite his due diligence, he remained unaware of the fraud. In the case of a control person, where a plaintiff proves the primary violation, the burden of proof shifts to the control person to prove that he exercised due diligence and still did not know or could not have known about the violation.

Furthermore, the Sarbanes Oxley Act ("SOX") and Dodd Frank Act have further expanded due diligence requirements. For instance, SOX requires Exchange Act reporting companies and issuers who have filed registration statements to establish independent "audit committees" to monitor auditing processes and procedures while ensuring the integrity of the company's financial information.[18] It also calls on the CEO and the CFO to certify the accuracy of financial disclosures and assume responsibility for establishing and maintaining disclosure controls.[19]

Furthermore, the Dodd-Frank Act sought to "reintroduce" due diligence in the offering process.[20] To this end, it called on the SEC to create rules that increase obligations on issuers of asset-backed securities to perform due diligence analysis of the underlying financial assets being securitized in that transaction and to disclose the nature of that review in their registration statements.[21] Accordingly, to implement section 945 of the Dodd-Frank Act, the SEC adopted Rule 193 under the Securities Act of 1933, which requires issuers to perform such a "review" of underlying assets.[22]

II. Pervasive Vagueness of the Due Diligence Standard

From the outset, the securities laws have always had a dual purpose. On one hand, they were designed to protect investors from corrupt practices by ensuring that investors receive full disclosure of material information concerning public offerings. Concomitantly, they seek to provide corporate actors with new regulatory parameters and guidelines to follow in their pursuits and business operations. However, to the detriment of insiders and outsiders alike, a critical concept woven into the foundation of all securities statutes continues to remain elusive—due diligence.

Although this concept is an integral part of statutory analyses, exactly what actions or procedures "due diligence" calls on corporate actors to undertake remains unclear. This doctrine begs several questions: What does due diligence require? Does it require management representation letters? What happens if such letters are unavailable or a schemer commits fraud? By nature, a schemer's activities are not openly conducted. Moving from the metaphysical world into reality, can any person imagine a schemer who would write or orally admit that he or she had engaged in the fraud? In addition, what actions would constitute a reasonable investigation? Moreover, who is the reasonable or prudent person? Are such notions defensible or are they merely snares to entrap? Does this mean that recipients of management representation letters should disregard them or conduct their own independent investigation? Of what use then would such letters be; what would be the cost of such an investigation; and would society and commerce really advance?

Many definitions of the due diligence standard have been advanced but continue to leave corporate actors confused and open to vulnerabilities.[23] For example, in one of its Notices to Members, FINRA attempted to identify several activities that members can do to fulfill their suitability obligations, particularly as members stray further away from traditional investments, which had been less profitable.[24] FINRA explained that members must undertake six activities to fulfill their due diligence obligations:

1. Conduct *adequate due diligence* to understand the features of the product;
2. Perform a reasonable-basis suitability analysis;
3. Perform a customer-specific suitability analysis in connection with any recommended transactions;
4. Provide a balanced disclosure of both the risks and rewards associated with the particular product, especially when selling to retail investors;
5. Implement appropriate internal controls; and
6. Train registered persons regarding the features, risks and suitability of these products.[25]

FINRA further reminded its members that "performing appropriate due diligence is crucial to a member's obligation to undertake the required reasonable-basis suitability analysis."[26] Typically, such an analysis verifies whether an investment is suitable for some investors, instead of customer-specific suitability determinations, which are conducted a customer-by-customer basis. A member must perform due diligence to ensure it understands the product's nature, risks, and rewards. After setting that standard, FINRA explained that the "type of due diligence investigation that is appropriate will vary from product to product." It proceeded to identify "some common features that members must understand about products before registered representatives can perform appropriate suitability analysis." Perhaps FINRA also

should have reminded its members that, as the great Roman jurist and orator Seneca said almost two thousand years ago, "an error is not counted as a crime."[27]

FINRA's definition of due diligence seems to be an unavailing tautology. It defines "due diligence" as "*adequate due diligence*." The other guidelines are equally general and ambiguous. FINRA also admits that "NASD's use of the term 'due diligence' is not intended to equate the responsibilities of a member for its sales conduct obligations with the requirements of an underwriter under" the Securities Act.[28] Therefore, FINRA's definition leaves corporate actors wanting a more concrete standard upon which they can base their practices.

The SEC attempted to provide guidelines for due diligence. It enacted Rule 176 to identify certain circumstances that factor into determining whether an investigation is reasonable and what constitutes reasonable grounds for belief under section 11(b) of the Securities Act.[29] According to Rule 176, relevant factors to be considered for underwriter due diligence include the "type of underwriting arrangement, the role of the particular person as an underwriter and the availability of information with respect to the registrant."[30] Otherwise, Rule 176 calls for consideration of the "type" of issuer, security, and person, the particular office held where the person is an officer, the "presence or absence of another relationship to the issuer when the person is a director or proposed director," the level of responsibility that the person had with respect to the fact or document, and whether he or she reasonably relied on others.[31]

In 1998, the Commission later proposed to amend Rule 176 to provide clearer guidance to underwriters.[32] In its proposal, the Commission "identif[ied] six due diligence practices that the Commission believe[d] would enhance an underwriter's due diligence investigation when conducting an expedited offering."[33] However, to date, the SEC has never adopted this proposed amendment.[34] The SEC has suggested "alternative" due diligence practices are acceptable, but emphasized that any alternatives should be "equally thorough."[35] Ultimately, no further advancements were made to clarify "due diligence."

Finally, the Dodd-Frank Act led the SEC to again reconsider the due diligence standard. In adopting Rule 193, the SEC attempted to clarify "due diligence" analysis, explaining that a "minimum standard of review is appropriate." [36] Like FINRA's suggested addition of "adequate" to the due diligence standard (as discussed above), the SEC's addition of "minimum standard of review" adds nothing but verbal freight to the definition of due diligence. The SEC called for a "flexible, principles-based standard that would be workable across a wide variety of asset classes and issuers" and "designed and effected to provide reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects."[37] Nevertheless, Rule 193 fails to specify any particular types of reviews that issuers should perform to fulfill the due diligence analysis requirement.[38] The SEC even admitted that it "expect[s] that the type of review of the assets an issuer performs may vary depending on the circumstances" and the "term 'reasonable assurance'…does not imply a single methodology, but encompasses the full range of reviews an issuer may perform to…to provide reasonable assurance."[39] The most specific guideline that the SEC provided issuers was to suggest that "sampling may be appropriate depending on the facts and circumstances."[40]

Instead of providing guidance to compliance departments and businesses as legislative drafters intended, the perpetual ambiguity beleaguering the due diligence standard has thrust corporate actors into a pool of uncertainty in determining their risks and vulnerabilities. Compliance departments are left uncertain as to exactly what standard different actors will be held to in litigation or prosecution, especially under a fraud theory brought with the benefit of hindsight. This uncertainty becomes even greater where corporate actors who are held to different standards wear multiple hats. For instance, if an inside director acts as a fiduciary, will the director be held to a due diligence standard under the '33 and '34 Acts or a fiduciary duty standard applicable to investment advisors under the 1940 Investment Adviser Act? Where does the line between of investment adviser begin and director end? Does it matter whether the director was a member of the corporation's "investment committee" of the Board? These vagaries remain a perpetual specter for corporations as they fashion and refashion their compliance policies to conform with the expanding regulatory environment.[41] On the other hand, are the standards retracting rather than really expanding in this, an election, year? Indeed, the Jumpstart Our Business Startups (JOBS) Act seeks to diminish regulation and investor protection in certain areas by alleviating government oversight of startups or "emerging growth companies" in their efforts to raise capital.[42] Either way, the problem has become even more acute in light of compliance departments' shrinking resources and budgets.[43] According to the recent survey undertaken by the Society of Corporate Compliance and Ethics, twenty-nine percent of respondents reported that they have "'nowhere near' enough funds to run effective compliance programs" and forty-four percent believe that they "have 'not quite enough' of a budget."[44] In light of this reality, the law should instead provide clearer guidance that corporate actors can appropriately incorporate into their business models.

III. Is Due Diligence a Sword or a Shield?

Both, as of late. Further exacerbating the confusion over opaque definitions of due diligence, the securities regulatory landscape has now become riddled with a morass of doctrinal weeds that are intertwining due diligence and reasonableness standards with willful or intentional conduct standards. Traditionally, due diligence and reasonableness standards have been viewed as creatures of negligence doctrines. In contrast, fraud requires *scienter*, or some type of willful or intentional conduct. To impose criminal liability, a court must find that a person "willfully" violated a statutory provision. The Supreme Court has noted that "willfulness" is a "word of many meanings, its construction often being influenced by its context," but generally it is intended to make "bad faith or evil intent" an element of the offense.[45] In the securities fraud context, the due diligence doctrine traditionally served as a shield for defendants to wield in their efforts to negate scienter. However, controversy over a recent jury verdict suggests that due diligence may also be used as a sword by prosecutors and the SEC.

Most recently, these standards were turned upside-down after a federal jury rendered a verdict in *SEC v. Frederick J. O'Meally et al.*, No. 06-CV-6483-LTS-RLE (S.D.N.Y. Dec. 16, 2011). On August 28, 2006, the SEC filed a complaint, alleging that Frederick J. O'Meally, a former registered representative of Prudential Securities Inc., defrauded sixty mutual fund families in whose funds he traded on his market-timing client's behalf. The SEC argued that O'Meally fraudulently deceived mutual funds that sought to exclude his market-timing trading from their funds. After two days of deliberation, an eight-person federal jury concluded that O'Meally did not commit any intentional wrongdoing and dismissed the fraud counts under Section 10(b) of the 1934 Act, Rule 10b-5, and Section 17(a) of the 1933 Act.[46] The jury found O'Meally liable for 6 of 60 charges of violations of Section 17a(2) and 17a(3) of the 1933 Act, which are negligence-based theories. Ultimately, the jurors concluded that O'Meally had negligently traded with six of the funds.

Although the verdict heavily favored the defense, the SEC claimed victory. It stated in a release that the jury found "in the SEC's favor on securities fraud charges."[47] O'Meally's attorneys claimed the release was "false, misleading and defamatory" and requested that Judge Laura Taylor Swain dismiss the case and sanction the SEC.[48] They claimed the jury found no liability for fraud, and explained that the "false impression left by SEC's press release is certain to have a detrimental effect on Mr. O'Meally's business and professional reputation."[49] In response, the SEC claimed that "violations of 17(a)(2) and (3) constitute fraud, albeit *negligence-based fraud* and not *scienter-based fraud*."[50] In its letter to Judge Swain, citing selective language from case law and examples of "negligence-based fraud"—an oxymoron to most people's minds—in common usage, the SEC argued that the statement was appropriate because the jury found that O'Meally "negligently engaged in a transaction, practice or course of business which operated or would operate on a fraud or deceit on the mutual funds."[51] This case raises a critical question that demonstrates the dangers of the due diligence standard's pervasive ambiguity—whether lack of due diligence or reasonable investigation constitutes fraud?

In light of the fundamental definition of fraud that attorneys and courts have understood for centuries, the answer should automatically seem to be "No." In *Aaron v. SEC*,[52] the Supreme Court held that to establish violations under 17a(2) and (3), the SEC need only prove that a defendant acted *negligently*, not with *scienter*, will, or intent.[53] While the SEC argues that sections 17a(2) and (3) constitute fraud because these provisions are *generally* part of the securities law anti-fraud provisions, this interpretation runs counter to hundreds of years of the Anglo-American legal tradition maintaining that "fraud" requires an intent or mens rea element, not merely a finding that a defendant failed to exercise reasonable care or due diligence.[54] The intent element has always been the fundamental feature distinguishing fraud or other intentional wrongdoing from negligence, which simply requires a breach in an applicable standard of reasonable care owed to a particular person or group.

Moreover, the SEC's sudden resort to claiming "fraud" victories in reliance on the *statute's captions* contravenes the Supreme Court's well-settled view that statutory captions and titles alone do not constitute law. Although the Supreme Court has recognized that statutory titles and section headings may provide "tools" for resolving "a doubt about the meaning of a statute,"[55] it has firmly established that such titles or captions cannot limit or substitute "the plain meaning of the text."[56] The Court has explained,

> Headings and titles are not meant to take the place of the detailed provisions of the text. Nor are they necessarily designed to be a reference guide or a synopsis. Where the text is complicated and prolific, headings and titles can do no more than indicate the provisions in a most general manner; to attempt to refer to each specific provision would often be ungainly as well as useless. As a result, matters in the text which deviate from those falling within the general pattern are frequently unreflected in the headings and titles. Factors of this type have

> led to the wise rule that the title of a statute and the heading of a section cannot limit the plain meaning of the text. [Citations omitted]. For interpretative purposes, they are of use only when they shed light on some ambiguous word or phrase. They are but tools available for the resolution of a doubt. But they cannot undo or limit that which the text makes plain.[57]

The Supreme Court and the Second Circuit have consistently declined to interpret statutes solely on the basis of their headings.[58] Therefore, under this precedent, although section 17 of the 1933 Act is captioned "fraudulent interstate transactions," Congress' reference to fraud in the title does not automatically transform every provision it enumerated in the text under the caption into fraud claims. It does not change the plain meaning of the text of sections 17a(2) and (3) and the historic standard of interpretation recognizing that the absence of any mention of scienter or intent signals the absence of fraud.[59] If Congress intended these provisions to count as fraud, it would have included such language in the text as it did in numerous other provisions of the securities statutes.[60] Indeed, the Supreme Court has emphasized that when a statute "can linguistically be interpreted to be either a meat axe or a scalpel[, it] should reasonably be taken to be the latter. Absent a text that clearly requires it, we ought not expand this one piece of the regulatory puzzle so dramatically as to make many other pieces misfits."[61] Under this robust body of case law, the SEC cannot first claim that a defendant committed negligence under a statute and later rely on the statute's caption to announce a "fraud victory" in its press releases.

Furthermore, if courts convicted parties for fraud for merely being conscious that they were engaging in a certain act and did not consider their mental state (i.e., whether or not the parties acted in good faith with a reasonable belief in their action's propriety or lawfulness), then the accused would be at the mercy of the SEC and prosecutors' whims. Only the mentally infirm or unconscious would be unaware that they are engaging in an activity. Such a broad standard would allow anyone to be found liable for "fraud." It would also contravene the Supreme Court's interpretation of willfulness. In *Trans World Airlines, Inc. v. Thurston*, the Supreme Court explained that "willfulness" requires proof that a defendant "knew or showed reckless disregard for" the violative conduct.[62] The Supreme Court has held that when interpreting a statute that requires "willful" conduct, courts must "give effect to the plain language of the statute."[63] It has also overturned constructions that equate willfulness or intent with negligence, and has explained that acting unreasonably does not constitute willfulness.[64] Furthermore, the Supreme Court has found that a person's good faith belief that he or she was acting in accordance with the law may obviate a finding of "willfulness" as an element of an offense.[65]

Such an interpretation would also run afoul of the Supreme Court's recent clarification of the doctrine of "willful blindness" and its admonition of proving knowledge through recklessness, negligence, or inaction. In *Global-Tech Apliances, Inc. v. SEB S.A.*, the Supreme Court explained that a plaintiff may prove a defendant's guilt by showing that the defendant was willfully blind to wrongdoing where the defendant (1) "subjectively believe[d] that there is a high probability that a fact exists" and (2) "t[ook] deliberate actions to avoid learning of that fact."[66] The Court found that recklessness and negligence are inadequate to prove a defendant's knowledge or intent.[67] It explained "[w]e think these requirements give willful blindness an appropriately limited scope that surpasses recklessness and negligence. Under this formulation, a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts."[68] Although the Supreme Court propounded this definition in the context of a civil patent dispute, it is highly likely to impact criminal prosecutions and administrative actions involving corporate defendants.[69] Historically, defendants' inadequate investigations sufficed to establish culpability in white collar prosecutions.[70] Now, *Global-Tech*'s focus on active efforts may lead courts to find that inaction alone is an insufficient basis to render a conviction.[71] To satisfy the *Global-Tech* elevated standard, defendants' ignorance of red flags or other reckless or negligent behavior is likely to be insufficient; defendants must instead be shown to have taken "clear, proactive steps with the sole purpose of cabining knowledge for an illicit purpose."[72]

Despite this well-established precedent, based on the SEC's interpretation, the due diligence standard may become a sword for prosecutors to use to charge any individual for pernicious activities and label it as "fraud." The SEC would be able to impose liability for fraud onto actors because they have not performed the proper "due diligence." Because due diligence continues to remain ambiguous and poorly defined, such a result would run afoul of due process, which "requires that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited."[73] This principle has been firmly recognized in the securities context as well as other areas of criminal law. For instance, the Second Circuit explained that the "Commission may not sanction [ ] pursuant to a substantial change in its enforcement policy that was not reasonably communicated to the public."[74] In the midst of the changing corporate ethics and compliance landscape, companies should not be

exposed to this greater uncertainty as they already face new challenges in navigating the increasingly complex global regulatory environment. Compliance professionals should not have to face such high levels of stress due to perpetually changing business and regulatory environments. As one chief ethics and compliance officer recently expressed, "the fear" for compliance departments is "a change in regulation that you don't hear about" because such changes "concern all of us" and "we are faced with different interpretations or a changing enforcement philosophy that creates confusion as to what is expected."[75] Therefore, a more concrete definition of "due diligence" is necessary for firms to recognize red flags, remain in compliance, and avoid a scarring conviction of fraud.

Endnotes

1. Reese Darragh, "Don't Jump! Compliance Officers Are Stressed Out," *Compliance Week* 1 (March 2012).
2. *Id.* at 40.
3. *Id.* at 1.
4. 15 U.S.C. § 77k(a)(5) (2012).
5. *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 657-58 (S.D.N.Y. 2004).
6. Milton Cohen, "Truth in Securities" Revisited, 79 *Harv. L. Rev.* 1340, 1355 (1966).
7. 15 U.S.C. § 77k(a) (2012).
8. 15 USC § 77k(b) (2012). *See, e.g.*, *In re Software Toolworks, Inc.*, 50 F.3d 615, 621 (9th Cir. 1994).
9. 15 U.S.C. § 77k(c); 17 C.F.R. § 230.176; *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 683 (S.D.N.Y. 1968). In *John Nuveen & Co. v. Sanders*, this issue was raised before the Supreme Court, but the petition for a writ of certiorari was denied. 450 U.S. 1005, 1005 (1981). However, Justices Powell and Rehnquist dissented and maintained that "reasonable investigation" was a higher standard than "reasonable care." *Id.* at 1008-1009 (Powell, J., dissenting).
10. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208, 47 L.Ed. 2d 668, 96 S. Ct. 1375 (1975) (explaining that due diligence is "in effect,…a negligence standard"); *In re Software Toolworks, Inc.*, 50 F.3d at 621; *Cal. Pub. Emples. Ret. Sys. v. Ebbers (In re Worldcom, Inc. Sec. Litig.)*, 308 F. Supp. 2d 214, 227 (S.D.N.Y. 2004).
11. 15 U.S.C. § 78j(b) (2012).
12. *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975).
13. *Ernst & Ernst*, 425 U.S. at 196.
14. *Titan Group, Inc. v. Faggen*, 513 F.2d 234, 238-39 (2d Cir. 1975), *cert. denied*, 423 U.S. 840 (1975)
15. *Schlick*, 507 F.2d at 380-81; *Miller v. Schweickart*, 413 F. Supp. 1062, 1067-8 (S.D.N.Y. 1976).
16. 131 S. Ct. 2060, 2070, 179 L.Ed.2d 1167 (2011).
17. Louis D. Brandeis, *The Brandeis Guide To The Modern World* 166 (1941).
18. 15 U.S.C. § 7241.
19. *Id.*
20. Securities & Exchange Commission, Release Nos. 33-9176, 34-63742, File No. S7-26-10, 17 CFR Parts 229 and 230, *Issuer Review of Assets in Offerings of Asset-Backed Securities*, at 41 (*quoting* S. Rep. No. 111-176, at 133 (2010) (*quoting* Senate committee testimony by Professor John Coffee)), *available at* http://www.sec.gov/rules/final/2011/33-9176.pdf (last visited February 14, 2012).
21. Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203, Section 942 (approved July 21, 2010), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/content-detail.html (last visited February 14, 2012).
22. 15 U.S.C. 77a *et seq.*
23. *See* H. Thomas Fehn, "Securities Arbitrators Guide to Due Diligence—Shield or Sword," *Securities Arbitration Commentator* (September 2011) (explaining the ambiguity over various definitions of due diligence and positing that due diligence is merely an "exercise in common sense").
24. *NASD Reminds Members of Obligations When Selling Non-Conventional Investments*, FINRA NTM 03-71 (November 2003), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003070.pdf (last visited February 14, 2012).
25. *Id.*
26. *Id.*
27. Lucius Annaeus Seneca, *Hercules Oetaeus*, Trans. by Frank Justus Miller, *available at* http://www.theoi.com/Text/SenecaHerculesOetaeus.html (last visited on March 27, 2012).
28. *NASD Reminds Members of Obligations When Selling Non-Conventional Investments*, FINRA NTM 03-71 (November 2003), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003070.pdf (last visited February 14, 2012).
29. Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act, 17 CFR § 230.178 (2012). *See also*, Securities Act Release No. 33-6335, 23 SEC Docket 401, 1981 WL 31062, at *14 (Aug. 18, 1981).
30. *Id.*
31. *Id.*
32. Securities Act Release No. 33-1167A, File No. 27-30-98, 1998 SEC LEXIS 2858, at *356-360 (Nov. 13 1998).
33. *Id.* The SEC enumerated the following six practices that courts should consider as "positive factors":

> 1. Whether the underwriter reviewed the registration statement and conducted a reasonable inquiry into any fact or circumstance that would cause a reasonable person [*358] to question whether the registration statement contains an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading;
>
> 2. Whether the underwriter discussed the information contained in the registration statement with the relevant executive officer(s) of the registrant (including, at a minimum, the chief financial officer ("CFO") or chief accounting officer ("CAO") or his or her designee) and the CFO or CAO (or his or her designee) certified that he or she has examined the registration statement and that to the best of his or her knowledge, it does not contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading;

3. Whether the underwriter received a Statement on Auditing Standards ("SAS") No. 72 comfort letter from the issuer's auditors;

4. Whether the underwriter received a favorable opinion from issuer's counsel opining that nothing has come to its attention that has caused it to believe that the registration statement contains an unfair or untrue statement or omits to [*359] state a material fact;

5. Whether the underwriter employed counsel that, after reviewing the issuer's registration statement, Exchange Act filings and other information, opined that nothing came to its attention that would lead it to believe that the registration statement contains an untrue statement or omits to state a material fact; and

6. Whether the underwriter employed and consulted a research analyst that:

(i) has followed the issuer or the issuer's industry on an ongoing basis for at least the 6 months immediately before the commencement of the offering; and

(ii) has issued a report on the issuer or its industry within the 12 months immediately before commencement of the offering.

Id.

34. *See* 17 C.F.R. § 230.176 (last amended Nov. 21, 2011); *see also Rescission of Outdated Rules and Forms, and Amendments To Correct References*, 76 FED. REG. 71872 (Nov. 21, 2011) (amending Rule 176 only by removing authority citations at the end of the sections); *SEC Official Defends Agency's Delay in Reforming '33 Act Offering Process*, 33 BNA SEC. REG. & LAW REP. 827 (2001).

35. Securities Act Release No. 33-6335, 23 SEC Docket 401, 406, 1981 SEC LEXIS 946, at *36 (Aug. 6, 1981).

36. Securities & Exchange Commission, Release Nos. 33-9176, 34-63742, File No. S7-26-10, 17 CFR Parts 229 and 230, *Issuer Review of Assets in Offerings of Asset-Backed Securities*, at 13-14 (*quoting* S. Rep. No. 111-176, at 133 (2010)) (*quoting* Senate committee testimony by Professor John Coffee)), *available at* http://www.sec.gov/rules/final/2011/33-9176.pdf (last visited February 14, 2012).

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. Reese Darragh, "Don't Jump! Compliance Officers Are Stressed Out," *Compliance Week* 40 (March 2012).

42. H.R. 3606 (2012), *available at* http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606pcs/pdf/BILLS-112hr3606pcs.pdf (last visited on March 27, 2012).

43. *Id.*

44. *Id.*

45. *Spies v. United States*, 317 U.S. 492, 63 S. Ct. 364, 87 L. Ed. 418 (1943).

46. *O'Meally*, 06-CV-6483-LTS-RLE, Dkt. No. 158.

47. Securities and Exchange Commission, *Jury Finds Former Prudential Securities Registered Representative Liable For Deceptive Mutual Fund Market Timing Practices*, Litigation Release No. 22196 (Dec. 16, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr22196.htm (last visited February 14, 2012).

48. *O'Meally*, 06-CV-6483-LTS-RLE, Dkt. No. 159 (Letter from Jonathan Harris to the Honorable Laura Taylor Swain dated December 16, 2011).

49. *Id.*

50. *Id.* at Ex. 2 (Email from Kevin M. Kelcourse, Assistant Regional Director/Enforcement of the Boston Regional Office to Jonathan Harris, O'Meally's counsel, dated December 16, 2011).

51. *Id.* (citing *Aaron v. SEC*, 446 U.S. 680, 693 (1980); *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992); *SEC v. Softpoint*, 958 F. Supp. 846, 861-62 (S.D.N.Y. 1997); *SEC v. Woodruff*, 778 F. Supp. 2d 1073 (D. Colo. 2011); American Bar Association, White Collar, Securities Fraud Subcommittee, "Trends in SEC Financial Fraud Actions: Part II" *Law360* (May 6, 2011); Peter Henning, "Dell May Hold Road Map for Goldman and SEC," New York Times Dealbook (June 16, 2010)).

52. 446 U.S. 680, 100 S. Ct. 1945, 64 L. Ed. 2d 611, Fed. Sec. L. Rep. (CCH) ¶ P97,511 (1980). *See also SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 856 (9th Cir. 1991) (holding that negligent preparation of an offering statement violates section 17(a).

53. Section 17(a)(2) prohibits a party from offering or selling securities by means of any "untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made." Section 17(3) prohibits parties from selling such securities to "engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

54. Sir James Fitzjames Stephen, 2 *A History of Criminal Law Of England* 121-122 (1883) (explaining that the definition of fraud has traditionally "contained two elements…namely, first, deceit or an intention to deceive or in some cases mere secrecy; and, secondly either actual injury or possible injury or an intent to expose some person either to actual injury or to a risk of possible injury by means of that deceit or secrecy.").

55. *Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 47 (U.S. 2008) (citing *Porter v. Nussle*, 534 U.S. 516, 528, 122 S. Ct. 983, 152 L. Ed. 2d 12 (2002)); *Almendarez-Torres v. United States*, 523 U.S. 224, 234 (1998) (citing *INS v. National Center for Immigrants' Rights, Inc.*, 502 U.S. 183, 189, 116 L. Ed. 2d 546, 112 S. Ct. 551 (1991)("[T]he title of a statute or section can aid in resolving *an ambiguity* in the legislation's text.") (emphasis added); *Trainmen v. Baltimore & Ohio R. Co.*, 331 U.S. 519, 528-529, 67 S. Ct. 1387, 91 L. Ed. 1646 (1947)).

56. *Fla. Dep't of Revenue*, 554 U.S. at 47 ("[A] subchapter heading cannot substitute for the operative text of the statute.") (citations omitted); *Pennsylvania Dept. of Corrections v. Yeskey*, 524 U.S. 206, 212, 118 S. Ct. 1952, 141 L. Ed. 2d 215 (1998) ("[T]he title of a statute…cannot limit the plain meaning of the text.") (quoting *Trainmen v. Baltimore & Ohio R. Co.*, 331 U.S. 519, 528-529, 67 S. Ct. 1387, 91 L. Ed. 1646 (1947)) (internal quotation marks omitted); *United States v. Minker*, 350 U.S. 179, 185 (U.S. 1956) (quotation omitted).

57. *Brotherhood of Railroad Trainmen v. Balt. & Ohio R.R.*, 331 U.S. 519, 528-529 (1947).

58. *See, e.g.*, *United States v. Reorganized Cf&I Fabricators*, 518 U.S. 213 (1996) (holding that a heading of the tax code is not controlling to determine whether money due constituted an excise tax); *United States v. Roemer*, 514 F.2d 1377, 1380 (2d Cir. 1975) (rejecting appellee's interpretation "that Rule 6 is inapplicable to this case because, according to the rule's caption, it deals only with delays in conducting retrials and the delay at issue in the instant case is in commencing a first trial"); *Roberts v. Amtrak*, No. 3:04cv1318 (PCD), 2006 U.S. Dist. LEXIS 13825 (D. Conn. Mar. 9, 2006) (finding a party's reliance on the title of a statute to be unpersuasive).

59. *See, supra*, note 42 and accompanying text.
60. *See, e.g.*, 15 U.S.C. § 78j(b) (2012).
61. *United States v. Sun-Diamond Growers of California*, 526 U.S. 398, 412, 119 S. Ct. 1402, 143 L.Ed. 2d 576 (1999).
62. *Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 105 S. Ct.. 613, 83 L. Ed. 2d 523, 36 Fair Empl. Prac. Cas. (BNA) 977, 35 Empl. Prac. Dec. (CCH) ¶ 34851 (1985).
63. *McLaughlin v. Richland Shoe Co.*, 486 U.S. 128, 108 S. Ct. 1677, 100 L. Ed. 2d 115, 28 Wage & Hour Cas. (BNA) 1017, 46 Empl. Prac. Dec. (CCH) ¶ 37966, 108 Lab. Cas. (CCH) ¶ 35067 (1988).
64. *Id.*
65. *Cheek v. United States*, 498 U.S. 192, 111 S. Ct. 604, 112 L. Ed. 2d 617, 91-1 U.S. Tax Cas. (CCH) ¶ 50012, 67 A.F.T.R.2d 91-344 (1991).
66. *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060, 2070, 179 L.Ed.2d 1167 (2011).
67. *Id.* at 2070-2071.
68. *Id.* The Court further clarified that "a reckless defendant is one who merely knows of a substantial and unjustified risk of such wrongdoing and a negligent defendant is one who should have known of a similar risk but, in fact, did not." *Id.*
69. Joseph F. Savage, Jr. & David McCrary, "Changing the Game: Willful Blindness After Globl-Tech," 19 *LJN Business Crimes Bulletin* 7 (March 2012) ("In the benchmark case of *United States v. Jewell*, 532 F.2d 697 (9th Cir. 1976) (en banc), for instance, the defendant was convicted of knowingly transporting drugs *exclusively* on the basis that he had exhibited little interest in the contents of the trunk of the car he had been highly paid to deliver to the United States shortly after declining to buy drugs from the car's owner. Post-*Global-Tech*, it is unclear whether this would be sufficient to support a conviction.").
70. *Id.*
71. *Id.* (internal citations omitted); *see also United States v. Ferguson*, 653 F.3d 61, 78-79 (2d Cir. 2011) ("Red flags about the legitimacy of a transaction can be used to show both actual knowledge and conscious avoidance").
72. *Id.* (citing *United States v. Stadtmauer*, 620 F.3d 238, 248 (3d Cir. 2010)).
73. *Upton v. SEC*, 75 F.3d 92, 98, Fed. Sec. L. Rep. (CCH) ¶ 99011 (2d Cir. 1996).
74. *Id.*
75. Reese Darragh, "Don't Jump! Compliance Officers Are Stressed Out," *Compliance Week* 1 (March 2012) (quoting Art Weiss, chief ethics and compliance officer at building products manufacturer TAMKO).

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Things Too Good to Be True Don't Usually Last

By Václav Rovenský and Jiří Horník

Until two years ago, the Czech Republic was regarded a country with stable and favorable investment conditions. In this article I will briefly describe the situation which eventually harmed Czech Republic' reputation as regards international investment because Czech Republic's legal environment is no longer regarded as stable.

In the process of EU accession negotiations Czech Republic, among other, undertook to increase the share of renewable energy sources up to 8% by year 2010 and up to 13% by 2013. Willingness to meet EU targets related to renewable energy sources, continuously updated by various EU directives, forced Czech legislators to come up with a package of incentives which would create conditions for such an increase, in a landlocked country with very limited possibilities of power generation from renewable energy sources. As it turned out later on, this package was designed too generously as it led to uncontrolled proliferation of photovoltaic power plants ("**PPPs**"), the so called "solar boom"[1], which eventually not only started to threaten the stability of the power grid, but the overall acceptability of the electricity price in the Czech Republic. Thus, Czech legislators had to come up with another set of laws, this time so controversial that it led to review of its constitutionality by Czech Constitutional Court and let to initiation of arbitration proceedings under which investors sought protection in accordance with international investment protection treaties.

1. How it started

In 2005 Czech Parliament adopted Act No. 180/2005 Coll., on the Support of Electricity Generation form Renewable Energy Sources, in which the Czech state implemented Directive 2001/77/EC of the European Parliament and of the Council of 27 September 2001 on the promotion of electricity produced from renewable energy sources in the internal electricity market. This act and related measures introduced very favorable conditions for investment to renewable energy sources projects as they guaranteed a long term stable support guaranteed by the state for this type of investment, consisting namely of the following measures:

(i) guarantee of the recovery of investments into the renewable energy power plant for the period of 15 years from commissioning of the PPP (state support through regulated purchase prices or green bonuses—see below);

(ii) right of the electricity producer for a priority connection of his PPP to the respective distribution or transport grid;

(iii) right of the electricity producer for priority transfer of electricity generated by his PPP; this right being effective for all the operating life of the PPP;

(iv) right of the electricity producer to demand that all electricity generated by his PPP is purchased by the operators of regional distribution grids;

(v) right of the electricity producer to choose between two types of support programs—feed in tariffs (regulated purchase price) and the so called "green bonus"[2];

(vi) guarantee of revenues per unit of electricity for 15 years and guarantee of continuous (although limited) increase of purchase prices annually set by the Energy Regulatory Office (between 2%–4% compared to purchase prices stipulated for the previous year);

(vii) guarantee of limited decrease of purchase prices set by the Energy Regulatory Office stipulated for new PPPs. The maximum admissible decrease for PPPs newly launched into operation was set at 5% compared to purchase prices for PPPs launched into operation during the previous year.

Apart from that the Czech legislators amended Act on Income Taxes and exempted the income tax from income received by operation of PPPs generating electricity in the calendar year in which they were commissioned and the following 5 years.

Unfortunately, the legislators have not foreseen several factors that led to the uncontrolled expansion of PPPs in the Czech Republic. Undoubtedly one of the strongest incentives of solar boom were high levels of state guaranteed purchase prices and green bonus set by the Energy Regulatory Office. For example, the purchase price and green bonuses for the electricity generated by the PPPs commissioned from 1 January 2006 till 31 December 2007 were twice as high compared to prices applicable to PPPs commissioned prior 1 January 2006. This, in connection with the annual limited permissible decrease of the purchase prices and green bonus applicable to PPPs newly launched into operation (and the necessity of annual, although limited, increase of regulated purchase prices), caused the inability of the Energy Regulatory Office to react flexibly on the increasing amount of PPPs and the increasing amount of provided state's support. To give some credit to the Energy Regulatory Office, the initial high purchase prices and green bonus were advocated by the high initial investments into PPPs in 2006. However, these dropped by 50% in the following four years, whereas guaranteeing the

return on investment not in 15 years, but given the level of guaranteed state support, in the range of 6-8 years. Indeed, this would create an ideal situation for investment into a high profit venture moreover guaranteed by the state.

The initial investment into the PPPs dropped mainly due to the situation on photovoltaic panels market, as the price of the panels, representing approximately 80% of the overall costs of a PPP, dropped by more than 40% in 2009. Actually the decrease was even higher due to the fact that the panels were mostly imported during a period when the exchange rate of Czech currency to U.S. Dollar was very convenient.

The business at that time was also fueled by the availability of external finance, as the banks were (due the legislation described above) more than keen to provide loans for PPP projects, as they considered these to be safe, given the prices guaranteed by state, with practically certain investment recovery and loan payback.

2. The "Solar boom"

The reasons described above caused that Czech Republic, despite its small surface and below average sunshine (compared to other parts of the world), became the fourth country in Europe and the sixth in the world as regards total installed solar capacity at the end of the year 2011.[3] The photovoltaic capacity increased in three years from 66 MWe at the beginning of 2009 to 1959 MWe at the beginning of 2012, i.e. almost thirty times. That would sound impressive if it were not for several serious troubles inseparably connected with such extensive and sudden increase in the volume of solar powered electricity incoming to transfer and distribution scheme, such as threat of possible "blackouts" and drying up resources of the Czech Republic, used for subsidising of the PPPs (i.e. purchase prices and green bonus)[4] and essentialy adherent potential risk of substantial increase of electricity price for the end users—meaning the consumers and businesses. The worst case scenario mentioned even the increase of electricity price to final consumers by 20%[5]. As a result Czech government and legislators had to reconsider the position of the state towards support of the PPPs and decided to introduce a new package of measures that would allow for elimination of the potential threats and that would reflect and transmit into the system of state photovoltaic support the fact that due to the significant decrease of the initial investment costs of PPPs the conditions of this business substantially changed.

3. How it came to an end

In order to tame the solar boom, Czech legislators adopted all range of measures that actually denied the first set of measures. Namely acts No. 137/2010 Coll., 330/2010 Coll. and acts No. 402/2010 Coll. and 346/2010 Coll.[6], and other regulations and price decision of the Energy Regulatory Office issued on the basis above. These regulations, effective mostly from 1 January 2011, after an extremely short implementation period, among others:

(i) enabled the Energy Regulatory Office to lower purchase prices significantly (as for the PPPs that were supposed to be commissioned in 2011 with recoverability of investment shorter than 11 years, the guarantee of maximum allowed 5% decrease of the purchase price between two consequent calendar years was totally canceled[7]);

(ii) cancelled any support for PPPs that were not connected to the distribution system by the end of February 2011, with exception of small PPPs with installed capacity up to 30 kWp on the roofs or enclosure walls of buildings listed in land registry;

(iii) imposed an obligation to pay a levy[8] on solar electricity generated in the period from 1 January 2011 to 31 December 2013 on those solar energy producers, whose PPPs were commissioned from 1 January 2009 to 31 December 2010 and provided that the installed capacity of their PPPs exceeded 30 KWe. The levy amounted to 26% in case of purchase price and 28% in case of green bonus;

(iv) imposed a tax on CO2 emission allowances acquired free of charge among other to coal burning power plants by making these subject of a gift tax amounting to 32% (even though not connected in any way to the solar boom);

(v) increased the fee for exemption of soil from agricultural soil fund, therefore making the construction of PPPs much more expensive (as most of PPPs were constructed on agricultural soil – pastures or fields);

(vi) cancelled tax holidays (grace period of approximately 5 years after the commissioning of the respective PPP) that had been applicable on all electricity producers from renewable energy sources since year 1993 on and prolonged term for depreciating of tangible property used for generation of electricity from solar energy on 240 months; and

(vii) limited the possibility to connect new PPPs to the grid.[9]

The controversy of these measures is obvious, especially if compared with the initial declaration of the Czech government embodied in the first set of measures intended to support the solar energy sources in the Czech Republic. The measures above led to initiation of several arbitration proceedings by investors that claimed that the measures were unconstitutional and did not seek public interest, as claimed by the legislators, but fiscal interests of

the Czech Republic and as such should be considered as unacceptable; none of these cases have been decided so far and many others have been waiting for the decision of the Constitutional Court. In order to stop the legal uncertainty about the legal nature of these measures and to prevent the expected large number of arbitration cases, 20 senators filed a constitutional complaint with Czech Constitutional Court on 3 March 2011, seeking annulations of several provisions from the second set of state's photovoltaic measures.

On 16 May 2012 Czech Constitutional Court decided on the constitutional complaint mentioned above and generally approved the measures taken by the Czech State focused on limitation of solar boom and its consequences, concluding that the choice of statutory provisions aimed at limiting state support for the production of solar energy is in hands of the legislature, provided the guarantees of investment return are preserved. The principle of legal certainty cannot be considered to be a requirement for an absolute absence of change in the legislative framework; that is also subject to other social-economic changes and demands on the stability of the state budget. The Constitutional Court considered it legitimate, after an objectively determined change of situation in investment into PPPs, to regulate support for the production of energy from renewable sources so as to maintain the balance between inputs and revenues established by the original version of act No. 180/2005 Coll., which was expressed in the fifteen year period for return on investment and a fixed level of revenues. At the end of the court ruling the Constitutional Court summarized, that although the contested provisions reduced the support provided to PPP operators, for the foregoing reasons this was not such an interference as would violate the constitutionally guaranteed rights of the affected persons, whether property rights or the freedom to conclude business, or would fail to observe the essential requirements of a democratic rule of law state, as the petitioners believe. In view of the sample calculations submitted in the proceeding before the Constitutional Court, the Constitutional Court concluded that the expected fifteen year period for return on investment was not fundamentally jeopardized by the adoption of the contested provisions; this is the position of the government, and was not persuasively cast in doubt by the petitioners.

Notwithstanding the obvious political aspects of the said ruling of the Constitutional Court, it should be mentioned that all is not lost, as at the same time the Czech Constitutional Court held that the conclusions above are general and it is not excluded that the impacts of reviewed legislation might be different in individual cases. In other words, should the individual investors be able to prove that their investment return has, in their particular case, been substantially hindered by the legislative measures designed to limit the effects of the solar boom, they should have a chance of success. And possibly help to build the trust in the Czech investment environment, which almost vanished a few years ago.

Endnotes

1. The amount of installed capacity of PPPs in the CR increased almost 7 times between the beginning of the year 2009 and beginning of the year 2010 and almost 4 times during the year 2010.
2. This system is convenient for minor investors, who use the generated electricity especially for their own consumption. Amount of green bonus is set by Energy Regulatory Office.
3. Available at: http://1bog.org/blog/infographic-top-ten-countries-that-use-solar-energy/. In the Prime Minister's statement of 24 October 2011 related to constitutional complaint of 20 Czech senators for revocation of several provisions of Act No. 180/2005 Coll. and several provisions of other acts, the Prime Minister stated, that in 2009 Czech Republic became one of the global leaders in construction of PPPs in terms of installed photovoltaic capacity per inhabitant (1. place Germany 46.2 W/inhabitant, 2. place Czech Republic 40,2 W/inhabitant) and that in 2009 Czech Republic installed photovoltaic capacity of 408 MW which corresponds to 84% share of the total annual growth of this sector in the European union even though the year 2009 was a year of solar boom worldwide—available at: http://www.concourt.cz/soubor/6378.
4. Due to increasing amount of producers entitled for such incentives.
5. Czech state support system of energy generation from renewable energy sources in the Czech Republic was based on the principle of transfer of a major part of financing of the support to the final consumer and state's budget. To be more precise, the statement above regarding the "major part" is not correct in case of state aid for generation of electricity from renewable energy sources in form of "operational aid," as in the given segment 100% of the state aid was transferred to the final consumer till the end of the year 2010, or as the case may be 2011. See http://www.concourt.cz/soubor/6378.
6. The two last ones were eventually subject of constitutional complaint filled by 20 Czech senators.
7. This caused a frantic race between the investors for connection of their PPPs before the end of the year 2010, because the purchase price for electricity generated by PPPs commissioned by 2010 (inclusive) was twice as high compared the purchase price of electricity generated by the PPPs commissioned in 2011.
8. Although the legislator called this measure "levy" it is in fact additional taxation.
9. This limitation lasted almost 2 years—until 1 January 2012.

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The Challenges of eDiscovery and Cloud Computing

By Jonathan P. Armstrong, Eric J. Sinrod and Philip Favro

One of the major developments in business over the last few years has been the rise in Cloud Computing. Often, however, the compliance aspects of moving data have been ignored. When moving data into the Cloud it is clear that careful planning will be needed. In this article we will try and make some sense of these issues and suggest practical ways forward. We'll look at some of the early regulatory pronouncements on eDiscovery in the Cloud and some of the wider issues corporations are likely to face when going through eDiscovery touching Europe. This article is divided into six main sections:

1. Data protection and privacy issues
2. Data export legislation
3. Works councils and employee rights
4. Contracting with your cloud provider
5. The USA PATRIOT Act and related laws
6. Conclusion

Data Protection and Privacy Issues

The UK data protection regulator, the Information Commissioner's Office (ICO), gave some advice on putting data into the Cloud in its Personal Information Online Code of Practice, which it published in July 2010. The Code recognizes the increasing use of Cloud Computing but reminds data controllers that the primary responsibility when data is passed into the Cloud remains with them.

The Code sets out two very helpful checklists. The first is for data controllers who are thinking of putting data into the Cloud and the second is for vendors to check their own services. The questions in the data controller questionnaire include:

1. Can the vendor confirm in writing that it will only process data in accordance with the data controller's instructions and will maintain an appropriate level of security?
2. Can the vendor guarantee the reliability and training of its staff, wherever they are based? Does the vendor have any form of professional accreditation?
3. What capacity does the vendor have for recovering from a serious technological or procedural failure?
4. What are the vendor's arrangements and record regarding complaints and redress—does it offer compensation for the loss or corruption of data entrusted to it?
5. If the vendor is an established company, how good is its security track record?
6. What assurances can the vendor give that data protection standards will be maintained even if the data is stored in a country with weak, or no, data protection law or where governmental data interception powers are strong and lacking safeguards?

The ICO say that if the answers to any of these questions raise concerns about a vendor's ability to look after your information, you should not use the provider concerned and should seek alternatives. Whichever jurisdiction is involved it would seem that the ICO's checklist would be a good start. Care should also be taken in eDiscovery to make sure that other basic principles are followed in addition:

1. The data being uploaded should be minimized—only store in the Cloud what you need and only store it for as long as you need it.
2. Data should only be processed fairly and lawfully—the rights of data subjects, even if they are suspects in an investigation or have been guilty of wrongdoing themselves, must always be respected.
3. Ideally consent should be obtained to the uploading of data in the Cloud. Consent is unlikely to be the whole story, however, as the basic principles of data protection must also be followed even with consent, and consent can generally be withdrawn at any time.
4. The data must be kept securely—a data processor will remain liable for the security of the data whether it is in his hands or not.

Where should data reside?

As a general rule it is best for personal data to stay local. In an internal investigation or discovery exercise, the least risk solution is almost always to look at the data in country. For example, in Europe if the data you need to examine relates to Spanish individuals it is best to do at least the first examination of that data in Spain. If that is not possible the second best option would be to do the first cut of the data in another European Economic Area (EEA) country. Ideally that data would stay in the EEA. Given the realities of multinational business, however, that is often not possible—for example, the data may be required for an investigation by authorities based in the U.S. or eDiscovery in litigation there. If that is the case then the first cut review of data should strip out any personal data which does not need to be transferred. The transfer of data should be proportionate to the purpose for which it is needed—for example, if the eDiscovery relates only to events between

1998 to 2000, then the first assumption should be that data outside those dates should not leave the EEA.

Bear in mind, however, that even this approach can cause difficulties. Moving data from one country to another could result in a submission to the laws of that country if the data is not simply in transit. In the UK, for example under s.5 of the Data Protection Act 1998 (DPA) if a data controller is not established in the EEA but uses equipment in the United Kingdom for processing the data other than "for the purposes of transit through the United Kingdom" it will be subject to the DPA's provisions. It is proposed that these requirements are widened under the proposed new EU Regulation; for example, the behavioural monitoring of EU citizens will be sufficient to submit to the jurisdiction.

Data security

It is important to check the security of the data both in transit and at its location. Increasingly data regulators across Europe have been concerned to secure personal data—the ICO, for example, has been involved in a number of regulatory actions concerning the transmission of data by post, email and fax and those investigations have resulted in fines of up to £325,000.[1] Of assistance in assessing whether security procedures are adequate may be the work done in November 2009 by the European Network and Information Security Agency (ENISA). ENISA was set up by the European Union (EU) to focus on information security issues in Europe. Its role is to carry out specific technical scientific tasks in the field of European security as a European Community Agency. Their Cloud Computing risk assessment is a worthy piece of work stretching to around 125 pages. It does not have the force of law but the report did include contributions from various academics and representatives of industry including Symantec.

In addition to the ICO and ENISA's work, many other data protection regulators in Europe have looked at some of the issues involved. In June 2010, for example, the Data Protection Commissioner of the German Land of Schleswig-Holstein issued his opinion on the legal issues around Cloud Computing. Germany has a split system of data protection regulation with the regulation of private companies conducted by a Data Protection Commissioner in each Land (roughly equivalent to a U.S. state). The Schleswig-Holstein Commissioner, Thilo Weichert, said that Clouds located outside the EU that hold data on Schleswig-Holstein citizens are per se unlawful even if the European Commission has passed an adequacy decision in favour of the country in question (as it has for Canada, for example). Dr. Weichert also cast doubt on whether the Cloud provider's self-certification to the U.S. Department of Commerce's Safe Harbor program could of itself provide an adequate level of protection when putting data into the Cloud. In February 2011 the Sedona conference reprinted Dr. Weichert's thoughts and in July 2012 he updated his guidance.[2] [3]

In an effort to bring some uniformity across Europe the Article 29 Working Party (WP29), a representative body made up of the data protection authorities in each EU member state, issued its own Opinion on Cloud Computing in July 2012.[4] The Opinion comments on EU law rather than any additions to that law in each individual country. It follows Dr. Weichert's concerns on adequacy and Safe Harbor. It reminds those putting their data in the Cloud that they must "choose a cloud provider that guarantees compliance with data protection legislation" and provides a list of issues that the contract with the provider should address, which are in many respects similar to those we have already discussed.[5]

Data export legislation

Whilst the issues created by data protection law in Europe are challenging it would be wrong to think that that is the end of the story. In addition to data protection legislation, data export laws exist in some parts of Europe to try and curb "le fishing expedition." The French authorities have looked to legislate against French documents being used in foreign proceedings since 1968. In 2007 the French Supreme Court upheld the conviction of a French lawyer for violating a Penal Law which provides that:

> Subject to international treaties or agreements and laws and regulations in force, it is forbidden for any person to request, seek or communicate in writing orally, or in any other form, documents or information of an economic, commercial, industrial or financial nature leading to the constitution of evidence with a view to foreign judicial or administrative procedures or in the context of such procedures

The lawyer concerned was fined €10,000.

Regrettably, courts in the U.S. have often been unwilling to consider the need to accommodate foreign data export laws when limiting eDiscovery. This has led to considerable concerns amongst the legal profession on both sides of the Atlantic. For example, the Sedona Conference, the American Bar Association and the New York State Bar Association have all highlighted the issue as problematical. In 2012 the American Bar Association passed its Resolution 103 where it urged that "where possible in the context of the proceedings before them, U.S. Federal, State, Territorial, Tribal and Local Courts consider and respect, as appropriate, the data protection and privacy laws of any applicable foreign sovereign and the interest of any person who is subject to or benefits from such laws with regard to data sought in discovery in civil litigation." Disappointingly, however, U.S. courts continue to regard U.S. litigation as supreme. Just this year, in *TruePosition, Inc. v.*

LM Ericsson Telephone Co., a U.S. court felt that the "strong national interest of the United States" would override the "weak national interest of France in prohibiting disclosure of information." For most organisations the challenge is which law they will break as the choice seems to be the rock of disobeying an American court or the hard place of acting unlawfully in Europe.

Works Councils and Employee Rights

In addition to the data protection and data export issues, those with substantial numbers of employees in Europe may need to consult with or inform their Works Council. Works Councils in Europe are bodies set up to protect employees' interests against the employer. The law on what a Works Council can and cannot do varies across Europe, although it is possible for some employers with more than 1,000 employees to have a European Works Council with whom they could negotiate for all of their facilities. A company's obligations when launching an eDiscovery project, or putting any data into the Cloud, may include the obligation to notify or consult with Works Councils.

Works Councils across Europe—including those in Germany, France, Netherlands and Austria—have objected to the way in which their member's data is handled. In France, for example, you may be legally obliged to tell your Works Council if you start any significant project for the introduction of new technology if that project is likely to have consequences for the employment, the classification, the pay, the training or the working conditions of your employees. Although it may not be a legal requirement to tell your Works Council about any movement of data into the Cloud, as your installation may not meet the test set by article L.2323-13 of the French Labour Code, it is good practice to tell your Works Council and this transparency generally increases acceptance. Traditionally, negotiations with Works Councils have been challenging, especially for any organisation reducing its workforce in Europe. Often Works Councils have used their rights to be consulted or informed about changes to data handling practices to extract concessions from employers in other areas. The courts in some countries, notably France and Germany, have been prepared to back employees against employers both in the implementation of schemes and also in halting schemes or investigations where the correct procedures were not followed. Europe does not recognize the concept of employment at will and employees often additionally have protection from dismissal save for cause and the right to a fair procedure even where cause is shown.

Having said that, there is at least some evidence that the tide in France may be turning slightly. In May 2012 a French regional court[6 7 8] upheld the dismissal of an employee who had sent confidential work-related data to his personal email account. The employee had sent 261 confidential technical files and he argued that the employer had violated his workplace privacy rights by examining his work emails to get the proof. The court disagreed and said that email sent by an employee using a computer provided by his employer for work purposes could be presumed to be professional mail that the employer could access without the employee's presence, unless the employee had identified the messages as personal.

Employee and Works Council rights must always be factored in to any governance and eDiscovery process. The law across Europe tends to be granular, with additional laws prohibiting interference with email communications. This category of law often carries heavier criminal sanctions than data protection legislation. Improperly collected evidence could be inadmissible in any subsequent proceedings and, in extreme cases, could land the collector with a criminal conviction. To address these concerns those leading the eDiscovery process will want to establish a list of the relevant countries involved in the process, and the number of individuals involved in each of those countries, at an early stage in the project. Armed with that information a proper assessment, using local counsel familiar with the legislation in each country, can be undertaken.

Contracting with Your Cloud Provider

It is obviously important when putting data into the Cloud to make sure that you do proper due diligence on the Cloud solution vendor and put in place a proper written agreement with that vendor. Under data legislation in Europe a written agreement will be needed. In addition it is important to be clear in the contract with the vendor what you are buying. Amongst the issues to look at especially would be:

1. **Limits on the vendor's liability**. It is common for vendors to seek to cap their liability at an unrealistically small amount—maybe even at the level of fees paid to them. Will this be adequate? Given that a security breach may cost over $1m, does the vendor have enough of a share of the risk? Bear in mind this is not just an issue of risk tolerance. If the vendor has only limited responsibility, can the legal requirement that the vendor is complying with "obligations equivalent to those imposed on a data controller" be met?
2. **Termination provisions**. It is important that the agreement contains proper termination provisions including addressing the vendor's insolvency, given that it is predicted that there will be substantial fallout in this industry as Cloud computing matures.

3. **The jurisdiction of the agreement**. Is it a jurisdiction that you are familiar with and are you happy to go there in a hurry if there is an issue with the vendor to take emergency proceedings to secure your data?
4. **Uptime**. All Cloud providers are not equal. What commitments will they give you to make your data available when you need it? Look also at how uptime will be calculated. Some vendors will only guarantee uptime and provide support during their business hours. If your main operations are based in Europe but the vendor is only committing to provide a service during business hours in California, how much use will that be to you? Will you be prepared to wait 8 or 9 hours until the support provider wakes up?
5. **Third party requests**. A good contract will put in place a contractual protocol which will detail how the Cloud vendor will respond to any third party requests for information (such as a subpoena) and whether the vendor is obliged to notify the company of those requests prior to producing the requested information. Be aware of the fact that the answer to this question is not always as simple as it may sound. Some countries (including the United Kingdom) have tipping-off provisions in some pieces of legislation. This could mean that the vendor would be committing a criminal offence if it complied with any contractual requirement to notify you before delivering up the requested information.
6. **The scope, type and purpose of the processing, the type of data and the category of data subjects**. An area which is unlikely to be controversial but seems to be specifically required by the Schleswig-Holstein opinion.
7. **Subcontracting**. Some almost virtual operations exist which sell Cloud computing and then subcontract any contracts that they have won. It is important that you know who you are contracting with. You will need to do due diligence and credit checks on your proposed vendor and their subcontractors. You should also try and find out where the facilities that will hold your data are located. If the data is held overseas, using corruption indices like those produced by Transparency International would also be wise. Anti-corruption law is toughening throughout the world (for example, with the UK Bribery Act 2010) but regrettably some outsourcing locations of choice still score poorly in corruption indexes. If those with the ability to access your data are poorly paid and from a country where corruption is rife, it stands to reason that the chances of your data being compromised are greater. A wise default position may be for the agreement to prohibit subcontracting of any kind without your prior written consent. The Schleswig-Holstein opinion also highlights this risk saying that *"due diligence should be done on subcontractors as well…at minimum, an independent entity must perform an outside audit and submit a report for the Cloud user's review. Because there are so many potential Cloud participants, the user must be informed as to which providers are actually processing the data at any given time…."*
8. **Timing and Assistance on Security Breaches**. Most reported security breaches these days seem to be vendor related. Dealing with the security breach is a fraught process and you will need co-operation from everyone involved. Your contract should make it clear that the vendor has to respond quickly. Remember that under the new EU proposals you may only have 24 hours to make multiple breach reports and so vendors are going to have to be able to assist you to prepare those reports promptly.
9. **Location.** You should also try and find out where the facilities that will hold your data are located. With many clients we have developed something we call for convenience the "Tripadvisor test." As the start in any data relocation exercise you should look up on Tripadvisor the location where your data will reside. If you are not comfortable going there on a business trip then consider whether it would be wise to send your data there.

   Any contract must include the minimum provisions of a data transfer agreement (DTA) even if all of the parties involved have signed up to the U.S. Department of Commerce's Safe Harbor scheme to protect the flow of data from the EU and or Switzerland to the U.S.. They should also include the ability to change the DTA elements of the agreement if the law changes.

   Also bear in mind that if you are moving data, DTAs need to be specific in some countries such as Spain and Germany. The EU model terms will not always work. Watch out also for strange provisions of U.S. or local law. For example, is there an export control prohibition on the type of encryption technologies that you are using to protect your data? If an investigation involves allegations of obscenity do you increase the risks by moving the data to another country which may be less tolerant of these issues?

The USA PATRIOT Act and Related Laws

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Ter-

rorism Act of 2001 (the USA PATRIOT Act), while expanding some government access to data in certain respects, did not create an entirely new regime of U.S. governmental access to information that greatly threatens data in the Cloud. Moreover, a recent comparative study indicates that it is inaccurate to assume that access by the U.S. government to data stored in the Cloud is greater than the access of governments in other advanced countries, as they also have anti-terrorism laws that afford similar expedited access.

Additional laws impacting government access

The FBI and other U.S. government agencies have previously been able to utilize a National Security Letter (NSL) as a type of administrative subpoena to seek records and data relating to government investigations. At the time the USA PATRIOT Act was enacted, there already were in place several U.S. Federal statutes, including the Electronic Communications Privacy Act (ECPA), authorizing the issuance of NSLs. The realm of NSLs was expanded in various respects by the USA PATRIOT Act and subsequent to this expansion the use of NSLs increased. NSLs gave rise to certain criticisms, some of which were abated by the USA Patriot Act Improvement and Reauthorization Act of 2005 (the Reauthorization Act). Nevertheless, while NSLs still are used, the data that can be sought from Cloud providers is generally limited to identification information, such as name, address, and length of service, but *not* the actual content of communications.

Often, the ECPA governs access to data maintained by a Cloud service provider. If U.S. authorities seek customer data from a Cloud provider, under the ECPA, a judge must issue a search warrant, an ECPA court order, or the government must issue a proper subpoena to the provider. When dealing with a court order or subpoena, notice usually is provided to the customer allowing for potential opposition, but this is not the case when it comes to search warrants.

True impact of the USA PATRIOT Act

The aftermath of the USA PATRIOT Act does not necessarily mean that data needs to be stored on cloud servers outside of the United States or with non-U.S. providers to prevent the data from being accessed by U.S. governmental authorities. Indeed, the United States and a number of European governments have entered into Mutual Legal Assistance Treaties (MLATs). Pursuant to a MLAT, two countries usually agree to the most expansive level of mutual assistance with respect to investigations or criminal offense proceedings. And in 2003, the United States and the EU entered into a MLAT containing a data protection provision. According to the comments to this MLAT, this data protection provision is designed to ensure that assistance generally will be provided and only will be refused on data protection grounds in exceptional cases. As a result, even if data were stored in the Cloud on European servers, European governmental authorities likely would cooperate with respect to a U.S. investigation. And even though the European Commission recently proposed a new Regulation and new Directive relating to personal data privacy, the proposed new Directive appears to maintain significant law enforcement access to personal data.

Approach of other countries

In addition, a recent review of the laws of the Australia, Canada, Denmark, France, Germany, Ireland, Japan, Spain, the United Kingdom and the United States reveals that the U.S. is not alone and that even countries that have strict privacy protections also have anti-terrorism laws that could allow for expedited government access to data stored in the Cloud.[9] Thus, "it is not possible to isolate data in the Cloud from governmental access based on the physical location of the Cloud service provider or its facilities."[10]

Conclusion

It is likely that in the years ahead we are going to see the need for investigations to be done in a more culturally astute manner. That might mean that companies have to use eDiscovery providers who have the ability to collect data in-country, and do the first analysis of it in-country before sending selected data back to the U.S.. It might include seconding people from the U.S. to Europe to help manage these investigations. And it will almost certainly mean using local counsel who understand the issues in the particular jurisdiction concerned, and who can act as a critical friend to the corporation in the investigation, questioning them on whether it has become over-broad in approach or whether the investigation is simply out of proportion to the wrong that is being investigated.

Whilst we all know that a serious allegation of the type that Enron suffered will have to be investigated in a very comprehensive manner, and whilst we all know that taking three packets of post-it notes home should not be investigated in the same way as the Siemens' investigation, the challenge for most corporations is that whole big area in the middle. When is an investigation serious enough to warrant the troops being mobilized? These areas are likely to continue to be difficult and wise counsel will be at a premium.

As we have seen in an eDiscovery exercise involving data in the Cloud issues that will need to be addressed include:-

- The need to limit the scope of the discovery exercise;
- The need to keep data in-country where possible;
- Restricting circulation—corporations need to get out of the habit of unintelligently copying people in "for information only," especially where those people are

in a different jurisdiction. In discovery consideration should also be given to apply into the U.S. courts for a protective order. With investigations and regulatory enquiries consideration should be given to seeking to agree on the scope of the discovery exercise and the possibility of steps like the anonymization of data;

- Arrangements in each relevant jurisdiction with outside counsel who could direct an investigation;
- Managing employee expectations before an incident—this could include sending a reminder to employees that their emails could be read where legally permitted;
- Doing due diligence on suppliers; and
- Checking data protection registrations.

The need then for law firms and eDiscovery consultants to know the culture in those countries where data is collected, as well as local law, will become ever more important. Data collection procedures will have to be tailored to suit each occasion to try and ensure both compliance with local law and the expectations of the court or regulator. Litigation teams will need to include data privacy specialists in all aspects of the investigation and may even need to include independent counsel to lay down ground rules on behalf of those being investigated.

Whilst this article has attempted to map out some of the challenges involved more will be encountered. Regrettably there is no one-size-fits-all approach. With that in mind the need for specialist assistance, proper resources and a clear mind is self-evident.

Endnotes

1. The £325,000 monetary penalty was levied on 1st June 2012 against Brighton and Sussex University Hospitals NHS Trust. Details are here http://bit.ly/Jy9hVm Details of other ICO enforcement activity can be found at www.ico.gov.uk.
2. See www.bit.ly/kmyh95.
3. The Schleswig Holstein revised guidance is here https://www.datenschutzzentrum.de/presse/20120713-datenschutzkonformes-cloud-computing.htm.
4. A copy of the Opinion is here http://bit.ly/TbcXmn.
5. The French data regulator CNIL also issued a paper on Cloud Computing in June with similar recommendations, http://bit.ly/MfwwcO. Also in June the Spanish data regulator AEPD issued guidance to law firms on the use of Cloud technologies, http://bit.ly/MXVYOg.
6. Pierre B. Epsilon Composite, Cour d'Appel, Bordeaux.
7. No. 4164, 10/2/01. Here the Cour de Cassation established the general rule that employees have the right to workplace privacy and that an employer cannot search an employee's personal messages stored on the company's computer without breaching that right to privacy. In a 2005 decision the court ruled that an employer could only search files identified as personal on a work computer in the presence of the employee, unless there was a particular threat to the company.
8. Philippe Ex v. Société Cathnet-Science, Cour de Cassation, number 04.40017,5/17/05.H.
9. *A Global Reality: Governmental Access to Data in the Cloud*, Maxwell & Wolf, Hogan Lovells, 5/23/12, http://bit.ly/MIY5rK.
10. *Id.* at 2.

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ISSN 0736-0150 (print) 1933-8597 (online)

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