NYSBA SPRING/SUMMER 2011 | Vol. 29 | No. 1

# Inside

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

CORPORATE COUNSEL SECTION
30th YEAR

## Message from the Chair

I am very excited to be leading the Section this year. It is a privilege to be able to contribute to this Section's long tradition of providing quality benefits to its unique membership. This year, the Corporate Counsel Section celebrates its 30th Anniversary and, with that in mind, the Executive Committee is working very hard to create an extraordinary year for our members. During the first few months of 2011, we have continued to lay the groundwork for new and exciting changes and we already have much to report.

The Section has grown tremendously over the last 30 years and we are striving to find new and innovative ways to continue to bring value to our membership. For example, in April, we conducted a CLE / networking event on Alternative Fee Arrangements at no cost to Section members. In March, we offered a scholarship to the Young Lawyers Section Trial Academy (including a travel stipend) to a NYSBA member nominated by a member of our Section. We also plan to have several social / networking events throughout the Spring and Fall at various venues to give you the chance to meet

## Inside



*Editors: Janice Handler and Allison B. Tomlinson*

**SPECIAL INTERNATIONAL ISSUE**

NYSBA

other Section members and discuss issues that are of importance to you.

In the Fall, we'll be conducting our fourth Corporate Counsel Institute. The Institute will again be a tremendous opportunity for you to learn about a variety of topics from experts in a collaborative setting. We are continuing our Kenneth G. Standard Internship Program and I am excited to announce that we have several new corporations involved and are working to place seven law school students in internships. Our Technology and New Media Committee has been working feverishly to update our website and to develop some innovative tools for in-house counsel. While we continue to be in the planning phase for many of the changes, look for new functionality before the end of the year.

Finally, I want to take this opportunity to give a huge thank you to my most recent predecessor, Allison Tomlinson for all the hard work she did during her time as Chair of the Section. In large part due to Allison's planning, this year should prove to be a very exciting and productive one.

Please do not hesitate to contact me with ideas you might have about the Section or if any of the programs mentioned above spark an interest in becoming more involved. I look forward to meeting as many of you as possible at our events during 2011!

**Gregory H. Hoffman**

# Being an International In-House Corporate Counsel Has Become a High-Risk Business

By Marvin G. Pickholz

Lawyers working in-house for corporations rightly see themselves as "lawyers for a client." Unfortunately, more and more, they are being viewed as "employees," producing a potentially dangerous consequence for their function and a genuine dilemma for their corporate clients.

Are international (or domestic) in-house lawyers true professionals performing a traditional role, albeit for a single client, or are they "employees," "gatekeepers," "watchdogs" and "ethicists?" Within the space limitations imposed upon the author, these notions will be highlighted, if not capable of explications.

### A. The Evolution of the Role of Modern Day Lawyers

In-house corporate counsel face increasing attacks upon their very function, if not existence as "lawyers." In today's environment, as attorneys for a single client, in-house counsel are confronted with domestic and international laws that are often competing and contradictory. This maze of laws would confound an entire law school faculty.

When a "serious issue" arises, in-house counsel are left to contend with anonymous "informed sources" who, from their unsifted and unproven claims, pronounce all forms of malignant intents upon the objects of their self-described "investigations."[1] Forgotten in this process is that the Constitution speaks of trial by jury instead of trial by accusation.

The head of KPMG's forensic practice has gone on record to point out the potential traps for a company that entrusts an "internal investigation" to its head of security or similarly titled employee and who are often former government investigators or police officers unrestrained by the niceties of law and believe they have *carte blanche*. The Financial Times quoted Richard Girgento, head of KPMG's U.S. forensic practice, as saying, "It's fine to delegate the day-to-day work but executives have to have oversight and insight."[2]

Conversely, ignoring suspicious circumstances may lead to serious issues for in-house counsel. Performing the roles assigned by them by their corporate employers may carry as much career risk for in-house counsel as ignoring signs of possible wrongdoing.

A recent New York decision creates the ultimate Catch-22. Jurisdictions like New York rigidly adhere to the doctrine that "where an employment is for an indefinite term, it is presumed to be a hiring at will which may be freely terminated by either party at any time for any reason or even for no reason." *Sullivan v. Harnisch.*[3] In *Harnisch*, both the Chief Compliance Officer and Deputy Chief Compliance Office were terminated while in the process of looking into matters related to institutional investment advisors and registered investment advisors. On the day they were to deliver their report to a senior executive of their employer, they were fired. The New York intermediate appellate court was constrained to apply New York law (which may well be the law in many other jurisdictions). New York's "at will" employment law took precedence over various other laws, including the employer's own Code of Ethics which required all employees "on pain of termination" to "determine" when alerted, whether an employee had engaged in any violation of its Code of Ethics. How can the law or regulators who enforce it declare in-house counsel to be "watchdogs," "gatekeepers," if they can be fired "at will" for following company policy, or the law? The federal obstruction statutes are discussed elsewhere in this article. While they, like various provisions of several federal statutes, are often pointed to as protecting in-house counsel, they often afford no protection to in-house counsel who are not ethereal concepts, but are real people with families and mortgages. In-house counsel understand that in the "big" case, the government may move because of the publicity such a case receives. On the other hand, the "little company, little case" may not merit government attention, or if it does, not for years. As a consequence, lawyers are losing historical protections and rights they enjoyed, just as their clients are losing privileges.

The role of the lawyer in Anglo-Saxon jurisprudence dates from the days of William the Conqueror. But it goes back far more deeply into time, to the ancient Greeks, the Hebrews, and Hammurabi. One suspects that even in their time of cave dwelling human societies needed, and had, those who performed the functions of lawyers, however rudimentary.

Hostility toward lawyers began, centuries ago, and legal advice has historically been judged with the benefit of hindsight. In 66 B.C., Cicero stated that advice is judged by results, not by intentions. Never more so than today.

Perhaps the complexities and international nature of modern business, use of new technologies by business, or the creation of new "financial products" to meet the needs of global business have overwhelmed and frustrated governmental authorities. Perhaps governments prefer to abandon over 1,000 years of grudgingly yielded "rights," including the right to an unfettered lawyer, in order to return to the time of William the Conqueror and his successor kings. Whatever the root cause, new notions about lawyers have spewed forth globally. Previously "zealous advocacy" on behalf of the client was a lawyer's ethical, moral and historical duty. The lawyer was not equated or synonymized with "cooperator" "concealor" or "fabricator." Once, governmental bodies reserved their forces for those lawyers who truly became parties in their clients' illegal activities. Not today. Today, lawyers are expected to be whistleblowers, gatekeepers and watchdogs. Addressing a client's historical or proposed legal actions with the eye of a trained professional will not suffice any longer to protect the lawyer, especially an in-house counsel. In one of the leading cases brought by the SEC in its history, *National Student Marketing,*[4] the trial judge cited the Revered Dean Wigmore's *Treatise as Evidence*[5] for the proposition that the protection of attorney-client communications has evolved from advice given in the context of "advocate," to advice given as legal "advisor." Dean Wigmore, and the *National Student Marketing* District Judge, traced the evolution to those "communications [now] made in seeking *legal advice for any purpose.*" The Canons of Ethics of all State jurisdictions prohibit, to one degree or another, a lawyer from revealing information within the ambit of "attorney-client privilege" *and* information which is described as "confidences" or "secrets" of the client. The latter afford far broader protections than to just "privileged" communications.

In a recent case, the lawyer, upon being informed of completed actions or contemplated actions, advised his client to make all haste to rectify that which was done and desist from that yet undone—and was assured the advice had been followed. Still, in charging the lawyer in a civil case, the SEC and court spoke not in words of "fraud," albeit a fraud was charged, but spoke of "*missed* signs," of what others were doing and of what those "*missed* signs" *might have* led another lawyer to do. "Missed" is a word denoting negligence, not a word embracing the "scienter, knowledge, or intent" needed for fraud. "Might have" are words of speculation if not evocative of *ex poste facto* concepts, and not a legal standard.[6] The notion has evolved over a period of forty-plus years that the Federal Securities Laws are not dependent upon measurable legal standards, but flow from an unconstitutionally vague and ill-defined standard of "*business ethics*…in *every facet* of [the securities idustry]."[7] In the global economy the obvious question is which country's notion of "business ethics" controls and, will it be recognized by other nations to protect the lawyer?

The standard now apparently being applied to all lawyers, with hindsight, is whether they "egregiously refused to see the obvious, or investigate the doubtful." *See Novake* v. *Kasaks*,[8] and *Chill v. Gen. Elec. Co*.[9]

The Assistant Attorney General in charge of the Department of Justice's Criminal Division has stated in several speeches that prosecuting individuals, including lawyers, is one of "the best ways to capture the attention of the business community."

Are lawyers now to be "investigators"? Are these new burdens sought to be imposed upon lawyers converting them from "watchdogs" into "bloodhounds?"

### B. Can In-House Counsel Know All the Laws of All the Jurisdictions in Which Their Corporate Client Does Business?

No. And to think that in-house counsel can have such a depth of knowledge is foolish or sheer vanity.

For example, how many in-house counsel are aware that the United States is a signatory to a United Nations Convention Against Transitional Crime,[10] which defines "organized crime" so broadly and so loosely as to sweep up any three or more natural or artificial persons who engaged in concert with the aim of committing one or more "serious crimes." A serious crime is one defined as punishable by a maximum prison sentence of four or more years. This definition could be stretched to cover almost every felony crime on a state or federal level in the United States. The Treaty also triggers an ability by representatives of the United States Government to carry out searches of, and seize property (computers) belonging to foreign entities, located on foreign soil. Before the Treaty is dismissed by the casual reader, attention needs to be focused upon Article VI of the United States Constitution. Pursuant to Article VI, "This Constitution…and all *Treaties* made, or which shall be made, under the Authority of the United States, *shall be the supreme Law of the Land*; and judges in every state shall be bound thereby; *any thing in the Constitution or Laws of any states to the contrary notwithstanding"* (emphasis added).

The Treaty is not the only method in vogue to circumvent domestic laws and constitutions. Writings between bureaucrats increasingly are divesting Congress of its constitutional supremacy to write laws governing Americans.

Memoranda of Understanding threatened to consign the Hague Conventions to the category of "ancient law," and Congress to a body retained to appear on evening news shows. Today, one "requesting authority" can contact a "receiving authority" by letter, often without court oversight or knowledge, and secure computers, hardware, documents, programs, even sworn statements from foreign nationals standing without any protection from the United States Constitution How does an in-house counsel deal with such activities?

Congress has joined in the effort to deprive citizens of basic fairness like being advised of the purpose of an investigation or their domestic or foreign legal rights if the investigation is for the benefit of a foreign body.

Congress empowered the SEC to conduct investigations, issue subpoenas for documents and take testimony all at the behest of a foreign authority.[11] This has created a notoriously open "back channel" whereby a telephone call from a foreign authority, unable to conduct such an investigation under its own laws or for political reasons, can start the investigative process. After receiving information from the U.S. authority of possible wrongdoing in that foreign land, what choice does the foreign authority have but to open its own investigation? More malignant is the usual refusal of the U.S. agency to advise the person called of the true identity of the "requestor" and what rights might be available to them under foreign law. Without the physical abuse usually attendant to "renditions," the question of whether such actions are tantamount to a "rendition" has not been adequately addressed by Congress or the Courts.

Corporate executives' first impulse is to handle a matter in-house, at least initially, with little thought given to the loss of protection usually afforded to attorney-client privilege and attorney work product. The assumption is that all civilized nations understand and accept these concepts. Wrong—not even within the EU. Some EU member states have no concept of attorney-client privilege or attorney work product, client "secrets" or "confidences." Others accept some of these notions but only when the attorney is not an in-house counsel or is an attorney admitted to practice in an EU member state. In Fall 2010, the EU Court of Justice, in *AKZO Nobel Chemicals Ltd. v. AKCOS Chemicals, Ltd*,[12] held that in-house counsel are just "employees" and, as such, their conversations and legal work are not protected by attorney-client or attorney work product privileges. The *AKZO* decision was foreshadowed by the EU Court of Justice's 1982 decision in *AM&S Europe v. Commission*,[13] where the EU Court of Justice declared the attorney-client privilege to be a "basic right" if the communications are made for the purposes of and in the interests of the client's *defense* and emanate from an "independent lawyer." Neither *AKZO* nor *AM&S* has resolved the issue of privilege where the documents or communicators occurred in a member state that recognizes the privileges but are sought by an EU Commission or member state which does not do so.

### C. Internal Investigations—Role of the In-House Counsel

Initially, every in-house counsel reporting suspicious activity to a senior official is told in substance to find out what it is about and if there is anything to it, to report back. Whether in-house counsel should perform this task or utilize outside counsel in specific instances will be driven by the circumstances.

In-house counsel engaged in an internal investigation will have exquisite decisions to make if they also are asked to, or regularly do, prepare an entity's annual or interim reports to the SEC, or other bodies, work on offering documents, or prepare and review warranties and representations to lenders or in acquisition matters, or interface with independent auditors. Can a participating in-house counsel withhold negative information as "privileged or work product" in the foregoing situations? Can in-house counsel sign or approve representations to any of these public or private organizations without disclosing the information?

The pressure to save legal fees often results in responses to the government, or the conducting of employee interviews, by in-house corporate counsel. As Moon follows Sun, so will a government body (or multiple ones) ask for the notes of the in house counsel and even that they testify in an investigative setting or before a grand jury. The decisions by in-house counsel regarding what documents are responsive to a subpoena, and the decision not to produce others, can have career altering consequences for an in-house counsel.

The recent multi-count indictment for alleged obstruction and false statements by a former in-house associate general counsel for a pharmaceutical company, in conjunction with the company's responding to FDA document requests, highlights the exposure of in-house counsel.[14] A "tenacious and zealous" in-house corporate counsel may become an "obstructer" of justice in the eyes of a prosecutor.

The evolutionary, if not recent revolutionary, demise of a lawyer's traditional role over the march of history can best be understood by comparing what is happening today with the following two quotations:

> Can there be any safer line to take than the practice of an art which gives you an ever ready weapon with which to protect your friends, to succor those to whom you are a stranger, to bring deliverance to persons in jeopardy, and even to strike fear and terror into the hearts of malignant foes—while you yourself have no anxiety, entrenched as you are behind a rampart of inalienable authority and power? Tacitus, *Dialogue on Orators.*

* * *

"[A]n advocate, by the sacred duty which he owes his client, knows, in the discharge of that office, but one person in the world, that client and none others." Lord Brougham, in defense of Queen Caroline before the House of Lords in 1820.

## Endnotes

1. After exonerating certain executives, and damaging their careers and reputations, Renault has admitted that it had falsely accused three former executives. The accusations were based on unproven

and anonymous letters. Renault moved swiftly after receiving the anonymous letters. So swiftly it acted as both accuser and judge. Or, as one of the now exonerated executives was quoted: "An anonymous letter carried more weight than my 31 years at Renault." See John Gapper, *Learning the Lessons of the Renault Affair*, Financial Times at 11 (March 17, 2011) (hereinafter "Financial Times").

2. *Id.*
3. *Sullivan v. Harnisch*, No. 115092/08, slip op. 9407, 2010 N.Y. App. Div. LEXIS 9480 (Appellate Division, First Department) (December 21, 2010).
4. *United States Securities and Exchange Commission v. National Student Marketing Corp.*, 538 F.2d 404 (D.C.Cir. 1976).
5. *See also*, The New Wigmore Treatise on Evidence, § 1.3.11.
6. *United States Securities and Exchange Commission v. Czarnik*, No. 10 Civ 745, 2010 U.S. Dist. LEXIS 125463 (S.D.N.Y. 2010); *see also In the Matter of Steven Altman, Esq.*, Admin. Proc File No. 3-12944, SEC Exh. Act. Rel of 1934, Rel. No. 63306 (November 10, 2010). The "Dodd Frank" legislation seems to have settled the split between Circuits whether an aider or abettor can be held liable only under a "knowledge" standard, *SECD v. Fehn*, 97 F. 3d 1276 (9th Cir. 1996), or whether "recklessness" is sufficient to establish "knowing" conduct. *Graham v. SEC*, 222 F. 3d 994 (D.C. Cir. 2000). Regardless, "missed" and "might have" are not infused with sufficient elasticity to rise to a "knowing" standard or a "recklessness" standard which is tantamount to "willful blindness."
7. *United States v. Naftalin*, 441 U.S. 768, 773 (1979).
8. 216 F. 3d 300, 308 (2d Cir. 2000).
9. 101 F. 3d 263, 269 (2d Cir 1996).
10. Jason Pickholz "Going Global: Political Corruption Investigations and Reciprocal Cooperation Under the UN Convention Against Transnational Organized Crime," *Insights From The Trenches*, ABA CJS (March 22, 2011), found at http://www2.americanbar.org/sections/criminaljustice/CR121212/Pages/pickholtz.aspx.
11. See SEC Routine Users of Information.
12. Case No. C-550/07 P, EU Court of Justice, September 14, 2010, posted on www.curia.europa.eu.
13. Case T. 155/79, EU Court of Justice (1982), posted on www.curia.europia.eu.
14. See 28 U.S.C. 1001 (making or causing to be made a false or fraudulent statement or representation in any matter within the jurisdiction of a federal agency). 18 U.S.C. 1503 (obstructing a grand jury); 18 U.S.C. 1512 (obstructing an official proceeding); 18 U.S.C. 1519 (known as the "anticipatory obstruction") Statute, 1509 allows the government to prosecute one who receives a document presentation notice but thereafter destroys or alters documents, e-mails and similar documents). Once receiving a request to preserve records, even without a subpoena having been issued for them at that time, in-house counsel and other members of a corporation must take steps to suspend the relevant document retention program and to preserve the records. Assuredly, those efforts will be one of the first questions of any corporate employee called to testify. The order in *U.S. v. Stevens*, F. Supp. 2d, Cr. RWT-10-694 (Titus, J) (D. MD May 10, 2011), granting a dismissal is instructive.

**Mr. Pickholz is a partner with Duane Morris LLP. He focuses on U.S. and international internal investigations and governmental actions arising from domestic and foreign regulatory schemes. He is the author of the treatise titled *Securities Crimes*.**

# Update on Canadian Transfer Pricing

By Jonah Mayles

Under the Canadian *Income Tax Act* (the "Act"), section 247 requires that the price paid for goods and / or services as between non-arm's-length parties must reflect a price that would be paid by arm's-length parties.

The Canadian transfer pricing landscape has been continuously evolving for two decades, and this change has quickened in recent years. There are currently several major transfer pricing disputes before all levels of federal courts—from the Tax Court of Canada to the Supreme Court of Canada—and the Canada Revenue Agency (the "CRA") has been evaluating and updating its policy in respect of the administration and enforcement of the transfer pricing regime in the Act.

This article will highlight some of those significant recent developments—including recent policies, decisions, and programs—all of which could affect multinational corporations in the U.S. with operations in Canada.

## CRA Approach to Transfer Pricing Methodologies

On February 24, 2011, the Ontario Bar Association convened a panel discussion on transfer pricing during which representatives of the CRA and private practitioners discussed current issues relating to transfer pricing. Particularly noteworthy was the presentation given by Jennifer Ryan, Director of the CRA's International Tax Division. Ms. Ryan provided some insight as to how the CRA intends to respond to and administer recent amendments made by the Organization for Economic Co-operation and Development ("OECD") to its *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* ("OECD Guidelines"). Ms. Ryan also provided certain transfer pricing statistics that had previously not ever been made publicly available by the CRA.[1]

Ms. Ryan commented on the OECD's recent decision to eliminate the hierarchy of methods to be used in determining an appropriate arm's-length price. The Canadian *Income Tax Act* does not provide a mechanism to determine an appropriate transfer price. Instead, the CRA has relied upon and endorsed the OECD's arm's-length principal as set out in the OECD Guidelines. Chapters I-III of the OECD Guidelines (which were amended by the OECD in July 2010) state that the "selection of a transfer pricing method always aims at finding the most appropriate method for a particular case." This updated language replaced the previous hierarchy of transfer pricing methods recommended by the OECD in 1999 and previously endorsed by the CRA in Information Circular IC87-2R, "International Transfer Pricing" (27 September 1999).

Since the July 2010 amendment, the CRA has not issued any public policy statements on how it would respond to the OECD's new position. Ms. Ryan clarified that the CRA adheres to and follows the OECD Guidelines and therefore the CRA will be updating its current position in respect to the elimination of the formal hierarchy of methods. Ms. Ryan stated that this update may not include a "full-blown" change to IC87-2R, but the CRA intends that "something" will be sent out to communicate the CRA's support of the OECD's current position.

However, Ms. Ryan went on to note that the new wording of the OECD Guidelines refers to the "method most appropriate in the circumstances." Ms. Ryan indicated that, based on this wording, the CRA's view is that there is a natural hierarchy that may "flow-out from that." Accordingly, the CRA's position as stated in IC87-2R may not contradict the CRA's evolving position.

Transfer pricing adjustments have for many years constituted the bulk of the tax recovered by the CRA on audits, and the recent statistics provided by Ms. Ryan confirm that the CRA intends to work aggressively in this area. For example, within the CRA's International Directorate, there are currently 339 auditors principally engaged in transfer pricing audits at the CRA's regional offices. Additionally, 30 auditors and 20 economists provide technical and economic support to the regional officers and auditors.[2] Further, in 2009 the CRA had 1,100 files in which transfer pricing issues were the principal or secondary grounds for reassessment, resulting in approximately $1.4 billion in tax being assessed. In 2010, the CRA had 1,200 files in which transfer pricing issues were the principal or secondary grounds for reassessment resulting in an additional $1.45 billion in tax being assessed.[3]

## Recent Canadian Jurisprudence

In Canada in 2005, there was more than $1.5 trillion in reported foreign transactions between related parties.[4] And transfer pricing can affect corporations of all sizes—even small businesses. In a recent case at the Tax Court of Canada, the CRA and Bridges Brothers Limited (a family-owned blueberry farming operation) settled on a proposed transfer pricing adjustment of $300,407.[5]

That said, the majority of transfer pricing disputes involve large corporations with hundreds of millions of dollars of potential tax at issue. Several well-known transfer pricing disputes continue to wind their ways through the courts.

In *GlaxoSmithKline Inc. v. The Queen*[6] ("Glaxo") leave to appeal to the Supreme Court of Canada was filed in

September 2010. In *Glaxo*, the taxpayer manufactured the well-known anti-ulcer drug, Zantac. The taxpayer purchased a chemical from a non-resident non-arm's-length supplier for approximately $1,600 per kilogram and this chemical was the key active pharmaceutical ingredient in Zantac. At the same time, generic drug manufacturers were purchasing the same chemical for $200 to $300 per kilogram. The CRA reassessed the taxpayer to make a downward adjustment to reflect the price that was reasonable in the circumstance (the excess was treated as a dividend paid to a non-resident and taxed accordingly). On appeal, the Tax Court of Canada upheld the CRA's reassessment. Subsequently, the Federal Court of Appeal held that the Tax Court had erred in not considering certain factors when considering the circumstances of the transactions. The appeal court referred the matter back to the Tax Court for reconsideration.[7] Essentially, the Court of Appeal stated that what is "reasonable in the circumstances" must be determined by examining the particular facts of each specific case. The legal question the lower court should have considered was what is a reasonable price that would be paid by an arm's-length party to purchase the chemical for manufacture of the branded Zantac product. In other words, the generic drug cost may not be an entirely appropriate comparable.

In *General Electric Capital Canada Inc. v. The Queen*[8] ("GE"), the U.S. parent of the Canadian subsidiary guaranteed all of subsidiary's debt and charged a guarantee fee, which was deducted by the subsidiary. The CRA reassessed the Canadian company and denied deduction, which was recharacterized and taxed as a dividend paid to a non-resident. The Tax Court allowed the taxpayer's appeal and held that the guarantee fee was reasonable because the guarantee provided an economic benefit that the subsidiary would not have been able to secure on its own.[9] The government's appeal to the Federal Court of Appeal was dismissed on December 15, 2010. Although leave to appeal to the Supreme Court has not been filed as of the date of publication of this article, pleadings have been filed in the Tax Court for later taxation years involving General Electric and other related entities.

Recently, the case of *Cameco Corporation v. The Queen* has begun making its way through the Tax Court appeal system. The CRA challenged the transfer pricing methodology used by Cameco and its wholly owned Swiss subsidiary in respect of the purchase and sale of uranium products. The CRA reassessed Cameco for the 2003 tax year to increase Cameco's Canadian taxable income by approximately $43,000,000. The CRA subsequently reassessed Cameco's 2004 tax year and increased its Canadian taxable income by approximately $108,000,000. Cameco expects the CRA will reassess it for the years 2005 through 2009 on a similar basis.[10] Additionally, since 2007, HSBC has been engaged in an on-going transfer pricing dispute with the CRA in respect of the value of guarantee fees.[11]

The outcome of tax litigation is always difficult to predict and the nature of transfer pricing disputes only increases the uncertainty. Accordingly, there is a significant incentive to settle potential (or on-going) disputes. In 2006, the U.S. Internal Revenue Service ("IRS") settled a transfer pricing dispute with GlaxoSmithKline Holdings (Americas) Inc. & Subsidiaries ("GSK") for the 1989 through 2000 tax years. Under the settlement agreement, GSK agreed to pay the IRS approximately $3.4 billion. Similarly, in February 2011 Daimler-Benz AG agreed to settle a Canadian transfer pricing dispute with two provincial governments and the federal government for the 1996 to 2007 tax years and paid $1.5 billion (U.S.) in tax.

## The APA Program

Advance Pricing Arrangements ("APA") provide taxpayers with a possible alternative mechanism by which to mitigate the risk of a transfer pricing adjustment. Although the APA program may help avoid an expensive and time-consuming battle in court, the APA program itself can be quite costly to the taxpayer.

An APA is an arrangement between a taxpayer and the CRA. Essentially, an APA confirms the appropriate transfer pricing methodology to a specific cross-border non-arm's-length transaction. The intention of the APA program is to prevent transfer pricing disputes by establishing the appropriate methodology beforehand rather than by way of an audit. The APA program began in Canada in July 1993 and it adopted much of the same procedures and guidelines as the U.S. system. The procedure and guidelines are published in Information Circular IC 94-4R, *International Transfer Pricing: Advance Pricing Arrangements* (APA) (dated March 16, 2001) or IC 94-4R (Special Release), *Advance Pricing Arrangements for Small Business* (dated March 18, 2005).

There are different types of APAs that may be entered into by a taxpayer. A unilateral APA is an arrangement solely between a taxpayer and one tax administration that does not involve a mutual agreement arrangement ("MAP"). A bilateral APA is an agreement between the Competent Authorities of two tax administrations under the relevant tax treaty. A multilateral APA is a mutual agreement arrangement between more than two tax administrations. Not surprisingly, the vast majority of bilateral and multilateral APAs concluded and currently under consideration by the CRA involve the United States. Currently, 71 percent of all bilateral and multilateral APAs and 77 percent of all completed APAs involve the United States.

The CRA has annually published a report outlining certain statistical information concerning its APA program. On July 7, 2010, the CRA published its most recent APA report for 2009-2010 (the "APA Report"). Based on the APA Report it appears that demand for the APA program (or at least taxpayer interest in the program) continues to outpace the CRA's ability to conclude APAs. There are currently 95 cases in the CRA's closing inventory of APA cases, up from 84 the year before and only 63 in 2007-2008. However, despite the growing inventory, the CRA was able to conclude more APAs this past year (16) than it has completed since 2003-2004 (only 10 APAs were completed last year and eight in 2007-2008). Moreover, the CRA's Patricia Spice, Director of the CRA's Competent Authority Services Division of the International and Large Business Directorate, recently stated that there are currently 18 analysts and 10 economists working in the APA program. As at the close of the 2009-2010 fiscal year, the program has accepted 253 cases and successfully resolved 142 APAs with Canadian taxpayers.[12]

In November 2010 the Canada and U.S. Competent Authorities entered into an agreement regarding the application of the arbitration procedure under paragraphs 6 and 7 of Article XXVI (Mutual Agreement Procedure) of the *Canada-U.S. Income Tax Convention*. The purpose of the agreement is to provide guidance under which the Canada-U.S. arbitration procedure will operate. In respect to the APA program, where the Canada and U.S. Competent Authorities have attempted but are unable to reach an agreement in a case initially submitted as a bilateral APA request, such a case will be eligible for arbitration. The arbitration can resolve disputes for both prior and future taxation years.

## Conclusion

It is not clear how the recent amendments made by the OECD or the CRA's approach to the revised OECD Guidelines will affect transfer pricing enforcement and jurisprudence in Canada. Furthermore, it is also unknown whether the arbitration procedure now provided under paragraphs 6 and 7 of Article XXVI of the Treaty will result in the CRA and taxpayers reaching a settlement rather than entering into an arbitration process in which the outcome is in the hands of a third party. However, one thing is clear: transfer pricing will continue to grow as a concern for corporations and their tax advisors as taxing authorities around the world continue to devote greater resources to administration and enforcement.

## Endnotes

1. Ms. Ryan was asked to swear an affidavit on the leave to appeal application to the Supreme Court in the case *GlaxoSmithKline Inc. v. The Queen* (Supreme Court of Canada Docket #33874). In order to obtain leave to appeal to the Supreme Court of Canada, the applicant generally has to prove that the issue in the case is of public importance or raises an important issue of law that warrants consideration by the Court. The statistics became available to the public due to Ms. Ryan's affidavit.
2. Affidavit of Jennifer Ryan, *GlaxoSmithKline Inc.*, *supra*, at para. 3.
3. *Ibid.*, at para. 5.
4. Memorandum of Argument of the Applicant, *GlaxoSmithKline Inc.*, *supra*.
5. File Number 2004-4811(IT)G. In its Consent to Judgement, the Tax Court reduced the reassessment to $105,000.
6. 2010 DTC 7053 (Fed. C.A.), rev'g 2008 DTC 3957 (T.C.C.).
7. *GlaxoSmithKline Inc. v. The Queen*, 2010 DTC 7053 (F.C.A.). (At the time of publication, the Crown sought leave to appeal to the Supreme Court.).
8. 2011 DTC 5011 (Fed. C.A.), aff'g 2010 DTC 1007 (T.C.C.).
9. *General Electric Capital Canada Inc. v. R.*, 2011 DTC 5011 (F.C.A.) confirming 2010 D.T.C. 1007 (T.C.C.).
10. Cameco 2010 Q3 Quarterly Report, Note 8.
11. On January 21, 2011, the Tax Court dismissed motions for a Determination of questions before hearing and to consider certain evidence in support of the first motion—2011 TCC 37.
12. Like Ms. Ryan, above, Ms. Spice was also asked to swear an affidavit on the Glaxo leave to appeal application to the Supreme Court. In her capacity at the CRA, Ms. Spice is responsible for entering into agreements with other countries regarding the taxation of Canadian taxpayer members of multinational enterprises involving transfer pricing—the APA program.

**Jonah Mayles is an associate in Fraser Milner Casgrain Law's Tax Group in Toronto, Canada. Jonah advises on a variety of tax matters including personal income tax planning for Canadian and foreign clients and advising on domestic and international corporate taxation and tax planning. Jonah has worked with clients in a wide range of businesses including manufacturing, transportation, and telecommunications.**

# Personal Jurisdiction in Canada: Can U.S. Defendants Be Subject to Suit With No Meaningful Contacts?

By Stephen J. Maddex and Ruba El-Sayegh

The United States and Canada enjoy very close cultural and economic ties. Canada is by far the United States' largest trading partner. In fact, bilateral trade between Canada and the U.S. is almost as large as the U.S.'s bilateral trade with China and Mexico combined, the U.S.'s second and third largest trading partners. As such, the likelihood that U.S. businesses will have dealings with Canadian companies or consumers is quite significant.

Despite their close ties, the Canadian and U.S. legal systems can be quite different. One of the most striking differences between the two systems (and one that can lead to surprising results) is the different rules governing Canadian and U.S. courts in determining when to assert jurisdiction over a foreign defendant.

## In the U.S., Jurisdiction Is Based on the Defendant's Right to Due Process

In determining whether a defendant should be subjected to a court's jurisdiction, the overriding concern for U.S. courts is protecting the defendant's constitutional right to due process. As the United States Supreme Court stated in *Burger King v. Rudzewicz,*[1] "[t]he Due Process Clause protects an individual's liberty interest in not being subject to the binding judgments of a forum with which he has established no meaningful contacts, ties, or relations," and therefore "gives a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some minimum assurance as to where that conduct will and will not render them liable to suit."

In this context, a defendant is entitled to a degree of fair warning that the defendant could be haled into court in another jurisdiction. This requirement is satisfied if the defendant has "minimum contacts" with the forum state and the exercise of jurisdiction comports with traditional notions of fair play and substantial justice. The test for "minimum contacts" depends on whether the plaintiff's claim relates to the defendant's contacts with the forum. If the claim is not related to the defendant's contacts, then the plaintiff relies on "general jurisdiction" over the defendant, which requires a showing that the defendant has established continuous and systematic contacts with the forum.

On the other hand, if the claim arises out of the defendant's contacts with the forum, then the plaintiff relies on "specific jurisdiction." To establish "specific jurisdiction," the plaintiff must show (i) the defendant "purposefully availed" himself of the privilege of conducting activities in the forum state, and (ii) there is a substantial connection between those contacts and the operative facts of the litigation.

To discern whether a defendant has sufficiently "purposefully availed" itself of a forum, three general principles apply: (i) contacts resulting from the unilateral activity of another party or third person are disregarded; (ii) the defendant's contacts with the forum must be "purposeful" and not random, isolated, or fortuitous; and (iii) "availment" means that the defendant must have sought some benefit or advantage by its forum-directed activities and invoked the benefits and protections of the forum's laws in some fashion.

If a defendant lacks sufficient contacts with the forum, absent other circumstances, the defendant should not be subject to the court's jurisdiction. One of the benefits of this framework is that it provides a degree of predictability to commercial dealings. Corporate executives can order their company's affairs in a manner that avoids creating significant contacts with foreign jurisdictions if they choose to do so.

## In Canada, Jurisdictional Law Is Relatively New and Unsettled

Until fairly recently, courts in Canada asserted jurisdiction only over defendants who were present within the territorial limits of the court or who voluntarily acquiesced to the authority of the court. As a result, asserting jurisdiction over a foreign defendant was rather difficult, leaving domestic plaintiffs with little choice but to sue foreign defendants elsewhere.

In 1975, the rules changed and Canadian courts began to focus more on the rights of domestic plaintiffs to seek redress for their injuries. However, more than a decade later, in *Morguard Investments Ltd. v. De Savoye,*[2] the Supreme Court of Canada recognized a need for judicial restraint and limited the authority of Canadian courts over foreign defendants to circumstances where there is a "real and substantial connection" between the forum and the defendant *or* the forum and the subject-matter of the dispute.

The Supreme Court of Canada described the "real and substantial connection" test in deliberately general language, which on the one hand allowed it to be applied in a flexible manner, but on the other lead to highly inconsistent and unpredictable results. More than a decade later, Canadian courts began to apply a balancing test that weighed a series of factors to determine whether a "real and substantial connection" existed.[3] The Ontario

Court of Appeal (Ontario's highest court) identified eight factors:

a. the connection between the forum and the plaintiff's claim;

b. the connection between the forum and the defendant;

c. unfairness to the defendant in assuming jurisdiction;

d. unfairness to the plaintiff in not assuming jurisdiction;

e. involvement of other parties to the suit;

f. the court's willingness to recognize and enforce an extra-provincial or international judgment rendered on the same jurisdictional basis;

g. whether the case is interprovincial or international in nature; and

h. comity and the standards of jurisdiction prevailing elsewhere.

While courts were required to balance all eight factors, the relationship between the factors or the relative weight of each factor was not clear. However, as long as a plaintiff could demonstrate a strong connection to the forum and that it would be inconvenient to litigate in a foreign jurisdiction, Canadian courts would be inclined to assert jurisdiction over a foreign defendant, regardless of whether the foreign defendant had purposefully established any contacts with the Canadian jurisdiction. As such, the balancing test often favored asserting jurisdiction over foreign defendants.

Further, when determining whether there is a connection between the forum and the defendant (factor "b" above), Canadian courts often applied a "reasonable foreseeability test" that was first established by the Supreme Court of Canada in *Moran v. Pyle National (Canada) Ltd.*[4] The so-called "Moran Principle" states that, when a foreign defendant places a product in the "normal channels of trade" and "knows or *ought to know*" the product would be used where the plaintiff was harmed, then the forum where the plaintiff suffered damage is entitled to exercise jurisdiction over that foreign defendant.

This point was made clear in *Stanway v. Wyeth Canada, Inc.*,[5] a decision by a trial court in British Columbia. In that case, a resident of British Columbia sued Wyeth, a U.S.-based corporation, and two of its U.S.-based subsidiaries, as well as several related companies based in Canada, for alleged personal injuries relating to the plaintiff's use of the drug Premarin. The U.S. defendants moved to dismiss the claims on the basis the court lacked jurisdiction over them. The U.S. defendants showed they did not maintain any offices or facilities in British Columbia, did not engage in any business in British Columbia, did not market Premarin or place it in the Canadian market, and did not test, market, label, distribute, promote or sell any of the products in question.

The court held, however, that the plaintiff's burden to establish a "real and substantial connection" is a low one, and that, because the U.S. defendants were engaged in some coordinated clinical research and marketing activities with respect to having the product approved for sale in Canada, *they should have known* there was a risk they could be sued in Canada. The court further held that "anachronistic" notions of "territorial sovereignty" were no longer relevant, and it would be far more inconvenient to force the plaintiff to file a separate lawsuit in the U.S. than it would be for the U.S. defendants to litigate in British Columbia. Therefore, despite the fact the U.S. defendants had no contacts with British Columbia and did not purposefully engage in any conduct in British Columbia, the court assumed jurisdiction over the U.S. defendants based on the convenience to the plaintiff in maintaining the entirety of her claim in British Columbia.

## Recent Developments Have Reinforced the Notion That the Threshold to Establish Jurisdiction in Canada Is Substantially Lower Than in the U.S.

In *Van Breda v. Village Resorts Limited*,[6] a recent decision by the Ontario Court of Appeal, the court was asked to determine whether an Ontario trial court was entitled to assert jurisdiction over a defendant based in Cuba—a Cuban company that manages Cuban resorts. In that case, two Ontario residents visited resorts in Cuba run by the defendant and suffered severe injuries as a result of accidents occurring on the resort premises. However, in conducting its analysis, the court determined that, in light of the uncertainty created by the balancing test mentioned above, the test should be simplified to its core principles—(a) the connection between the forum and the plaintiff's claim and (b) the connection between the forum and the defendant.

### (a) Connection between the forum and the plaintiff's claim

Generally speaking, Canadian courts take into account where the damages occurred in determining the forum's connection to the dispute. Damages suffered within the jurisdiction are typically regarded as a significant connection. As such, in most instances, when a plaintiff in Ontario sues a foreign defendant, the plaintiff will be able to establish a strong connection with Ontario, given that the plaintiff would be located in Ontario and likely would have suffered damages in Ontario.

### (b) Connection between the forum and the defendant

Accordingly, as a result of *Van Breda*, the question of whether a court should assert jurisdiction over a foreign defendant typically will depend on the strength of the contacts the defendant has with the forum. When assessing the connection between the forum and the defendant, courts primarily focus on conduct by the defendant within the jurisdiction and the defendant's "reasonable foreseeability." Unlike in the U.S., however:

i) the reasonable foreseebility of the defendant is applied on an objective rather than subjective standard;

ii) contacts with the forum are not required; and

iii) the defendant's contacts do not have to relate to the claim or cause of action.

### i) Reasonable foreseeability

As explained above, in Canada, where a defendant knows, *or ought to know*, that harm would occur within the forum, asserting jurisdiction could be proper. In other words, even if the defendant had no actual knowledge that harm would occur in Canada as a result of its conduct and had no intent to cause harm in Canada, if the plaintiff can show that a reasonable defendant *should have known* harm would result in Canada, the Canadian court could assert jurisdiction.

While the reasonable foreseeability test has been applied to this analysis since 1975, the new state of the law is problematic for U.S. defendants because *Van Breda* has lowered the threshold even further by eliminating 6 out of the 8 factors to be weighed in establishing a real and substantial connection. Therefore, the need to balance the competing interests of the plaintiff's right to a convenient forum with the unfairness to the defendant in being forced to litigate in a foreign jurisdiction has been abandoned in favor of a simpler test that seems to inadvertently or otherwise place a higher degree of importance on the reasonable foreseeability of the defendant. Therefore, when reasonable foreseeability is found (which is not difficult to do under an objective standard), there are no other factors available to swing the pendulum in the other direction. The only other factor considered at this stage of the analysis is the connection between the plaintiff and the forum, which is almost always present if the plaintiff resides in the forum Canada and suffered damages in the forum.

### ii) Contacts with the forum are not required

Although closely connected to the reasonable foreseeability test, the court also made clear that, while the defendant's contact with the jurisdiction is an *important* factor, it is not a *necessary* factor. Therefore, under the right circumstances, a Canadian court could assert jurisdiction over a foreign defendant regardless of whether the defendant has any substantial contacts with the forum whatsoever. In fact, contacts can be drawn entirely by the plaintiff between the defendant and the forum, rather than by the defendant linking itself to the forum directly. For example, if a Canadian resident learns about a business opportunity on the website of a U.S. company, travels to the U.S., establishes a relationship between itself and a U.S. entity, and enters into a contract in the U.S., which is later breached in the U.S., the U.S. defendant could be haled into a Canadian court based on a showing that the defendant should have known harm would occur in the Canadian resident's jurisdiction.

### iii) Contacts do not have to relate to the claim or cause of action

In *Van Breda*, the plaintiffs argued that the Cuban defendant had a connection to Ontario because it conducted marketing in Ontario. However, the plaintiffs made no attempt to show the defendant's marketing activities in Ontario had any relationship to them or to their causes of action. The plaintiffs' claims were that the resorts negligently caused the plaintiffs' injuries—i.e., that a diving operation was conducted negligently in one case and that exercise equipment was not properly maintained in the other. The plaintiffs did not claim that the defendant's marketing materials misrepresented the safety of the diving operation or exercise equipment or even that the plaintiffs were aware of or relied on the defendant's marketing activities in making plans to visit the resort.

In other words, contrary to the "minimum contacts" analysis in the U.S., which limits specific jurisdiction to circumstances where the plaintiff's injuries "arise out of or relate to" the defendant's activities directed at the forum, under the rubric established in *Van Breda*, a defendant who maintains contacts with Canada could be sued in Canada, even if those contacts are attenuated and isolated and have nothing to do with the plaintiff's claim.

## Conclusion

Recent developments in the law of personal jurisdiction in Canada make clear that U.S. businesses that engage in commercial activities with Canadian businesses and/or consumers could be sued in Canada for claims that have nothing to do with any contacts they have purposefully created in Canada. Indeed, jurisdiction could be asserted over U.S. businesses even if the company has engaged in no intentional acts directed at the Canadian forum. Merely assuming a Canadian court will apply well known U.S. principles would be a mistake that could lead to extremely surprising results.

## Endnotes

1. 471 U.S. 462, 471-72 (1985).
2. [1990] 3 S.C.R. 1077.
3. *See Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 (Ont. C.A.).
4. [1975] 1 S.C.R. 393.
5. 2008 BCSC 847.
6. 2010 ONCA 84.

**Stephen J. Maddex and Ruba El-Sayegh are associates in the Commercial Litigation Group of McMillan, LLP, in Ottawa, Ontario.**

# Foreign Investment in Canada—Is the Door Still Open?

By Shawn C.D. Neylan and Michael Kilby

In March 2009, significant amendments to Canada's Investment Canada Act (the "ICA") were passed, with important implications for the regulatory review of mergers and acquisitions from a foreign investment control perspective. These amendments, combined with three highly scrutinized, high-profile transactions, culminating in the rejection of BHP Billiton's $40 billion proposed acquisition of Potash Corporation of Saskatchewan ("PotashCorp"), have drawn considerable attention to the ICA, and have generated widespread debate within the Canadian foreign investment bar, corporate Canada, policymakers and academia as to the appropriate role of government in screening, imposing conditions on, and approving foreign investment in Canada. Most recently, parliamentary hearings regarding further potential changes have been commenced.

This article examines Canada's new national security test for foreign investment and considers recent developments in the form of three controversial transactions, concluding that each of the three transactions likely represented special cases, and are not indicative of any broader trend towards greater foreign investment restrictions. On the contrary, foreign investments in Canadian companies continue to be approved with regularity and, other than with respect to certain key sectors which have always been subject to tight foreign investment controls (*e.g.*, banking, air transportation, uranium production), Canada very much remains open for business. For transactions subject to the ICA, the approval rate certainly exceeds 99%. We start with an overview of the 2009 amendment which created an explicit national security test for foreign investment in Canada, not unlike the CFIUS regime in the United States.

## A. The National Security Test under the Investment Canada Act

The ICA provides for the pre-closing review and Ministerial approval of certain investments in Canadian businesses, with such approval granted where the Minister determines that an investment is likely to be of "net benefit to Canada." Prior to March 2009, the ICA did not contain any explicit "national security" review mechanism. A brief overview of Canada's new "national security" review regime under the ICA follows.

A national security review may be launched where the Government regards a foreign investment as potentially "injurious to national security." If it concludes that there is such a potential threat, the Government can prohibit or attach conditions to a foreign investment, whether an investment in an existing Canadian business or the establishment of a new Canadian business. If the investment is already completed, the Government's powers include the ability to order the divestiture of a Canadian business. It is important to note that this mechanism for national security review is separate from the existing economic review process.

The national security amendments to the ICA raise a number of issues, including the following.

### National Security Is Undefined

The ICA does not define "national security." The Government has not provided any meaningful guidance on the factors it will consider when determining whether there is a national security issue. The concern that national security could be interpreted expansively (beyond obvious defence-related concerns) is heightened by the large and varied group of governmental departments and agencies listed in the National Security Review of Investments Regulations (the "National Security Regulations") including the Department of Canadian Heritage, the Department of Natural Resources, the Department of Transport, the Canada Revenue Agency, the Department of Public Works and Governmental Services and the Department of Finance, in addition to the more obvious agencies such as the Department of National Defence and the Canadian Security Intelligence Service.

### Small Transactions and Other Investments Are Subject to the New Law

Unlike the case in economic reviews under the ICA, the new national security review law applies to minority investments. Also, under the new law, the government may order a review if the business in question carries on any part of its operations in Canada and has any of: a place of operations in Canada; one or more individuals who are employed or self-employed in connection with the operations; *or* assets in Canada used in carrying on the operations.

### No Process for Voluntary Pre-Clearance

The ICA does not provide a pre-clearance process for national security issues. However, in some cases the National Security Regulations provide for a statutory limitation on the Minister's ability to act after a certain date. In some cases it may be possible to have the limitation period expire before closing. If this is not possible, there will be some (in most cases minimal) risk of a post-closing national security review.

### State-Owned Enterprises (SOEs)

In December 2007 the government issued guidelines on how it will apply the "net benefit to Canada" test to investments by SOEs that were being reviewed under the economic review provisions of the ICA (not the new national security law that was not then in force). In addition to the factors that the Minister of Industry typically considers in deciding whether to approve reviewable investments, the SOE Guidelines indicate that the governance and commercial orientation of SOEs will be considered.

With respect to governance, the SOE Guidelines state that the SOE's adherence to Canadian standards of corporate governance will be assessed, including any commitments to transparency and disclosure, independent directors, audit committees and equitable treatment of shareholders, as well as compliance with Canadian laws and practices. The Minister will also consider how and to what extent the investor is controlled by a state.

With respect to the commercial orientation, the SOE Guidelines state that the following will be relevant: (i) destinations of exports from Canada, (ii) whether processing will occur in Canada or elsewhere, (iii) the extent of participation of Canadians in Canadian and foreign operations (iv) the support of on-going innovation, research and development; and (v) planned capital expenditures in Canada.

Finally, the SOE Guidelines outline the types of binding commitments or undertakings an SOE may be required to provide to pass the "net benefit" test. While many of these include commitments required by any foreign purchaser, of particular interest is the potential requirement to list the shares of the acquiring company or the target Canadian business on a Canadian stock exchange.

## B. In Practice, the National Security Test Has Not Played a Major Role to Date

Despite the uncertainty generated by the introduction of the national security review process in Canada, foreign investors should in most cases not be overly concerned for a number of reasons.

### Experience with National Security Reviews to Date

As at the date of writing, there has apparently only been a single national security notice (not a full review) since the new law came into force a year ago. Moreover, as at the date of writing, even under the "net benefit to Canada" test that is applicable to economic reviews, there have only been two non-cultural investments rejected in the quarter century since the ICA came into force (the ATK–MDA aerospace transaction, and the BHP Billiton—PotashCorp transaction, both described below).

### Canada Has an Open Economy

Canada's economy has historically been open to foreign investment. In 2009 (not a particularly active year for global foreign investment) 22 transactions were approved by the Minister of Industry under the economic review provisions of the ICA including three significant investments by SOEs: (i) China National Petroleum Corporation's acquisition of control of Athabasca Oil Sands Corp., (ii) Korea National Oil Corporation's acquisition of Harvest Energy Trust and (iii) Abu Dubai's International Petroleum Investment Co.'s acquisition of NOVA Chemicals Corporation. Also, China Investment Corporation's acquisition of a 17% interest in Teck Resources Limited was successfully completed in 2009. Furthermore, in 2010, Sinopec's acquisition of an interest in Syncrude received approval under the ICA. No SOE transactions have been formally rejected, to date.

## C. Three Cases under the Investment Canada Act

In the years immediately preceding and then following the introduction of the national security test in 2009, three significant foreign investments have led to important developments under the ICA. In 2008, an economic review of the proposed acquisition of the information systems business of MacDonald, Dettwiler and Associates Ltd. by U.S.-based Alliant Techsystems Inc. resulted in the first formal refusal of a non-cultural transaction under the ICA, when the Minister of Industry (the "Minister") concluded that the acquisition would not likely to be of net benefit to Canada. In 2009, for the first time in the history of the ICA, the Attorney General of Canada instituted legal action against an investor, U.S. Steel Corporation, for allegedly failing to respect undertakings given in respect of a foreign investment. Finally, in the fall of 2010, the Minister decided that Australia-based BHP Billiton's ("BHP") hostile takeover bid for the PotashCorp would not likely to be of net benefit to Canada. While these three events have led some to question what message Canada is sending to international investors, careful examination of the facts of each case suggests that each can be viewed as an extraordinary event and, as such, is not indicative of any wider trend towards protectionism.

### 1) MacDonald, Dettwiler and Associates Ltd.

The first foreign, non-cultural takeover to be formally blocked under the ICA was the CDN$1.3 billion proposed acquisition of the information systems and geospatial businesses of MacDonald, Dettwiler and Associates Ltd. (MDA) by U.S.-based Alliant Techsystems Inc. (ATK) in 2008.[1] The Minister refused the transaction on the statutory basis that he was not satisfied that it would likely be of a net benefit to Canada.

MDA, perhaps best known for making the Space Shuttle's "Canadarm," is a leading Canadian satellite and aerospace company. It has benefited from significant government funding in the past and has played an important role in the surveillance of Canada's Arctic through the provision of satellite images and information. Vociferous public opposition to the proposed sale of MDA to a U.S. defence company arose upon announcement of the transaction, and opposition political parties took unfavourable positions. The Minister ultimately rejected the transaction.

In the wake of the decision, the Minister emphasized that: "This is not a protectionist government. This is a government that is encouraging investment in our country." On the other hand, supportive of the Minister's decision, the Prime Minister cautioned that "[n]o one should doubt the determination of this minister or this government to protect this country's interests."[2]

Although the decision was arguably illustrative of a general trend over the past several years towards more vigorous reviews under the ICA, characterized, for example, by a gradual increase in the number and scope of undertakings required of foreign investors, rejection of the MDA transaction did not, generally speaking, elicit significant concerns of a broader chilling effect on foreign investment in Canada. On its own, the case primarily offered a warning to investors that, perhaps to the surprise of some, the government was prepared to actually block a non-cultural transaction under ICA, under the broad discretion granted to the Minister. Many observers concluded (rightly so, in the authors' opinion) that the MDA transaction did not signal a fundamentally different approach to foreign investment on the part of the Canadian government, but rather effectively amounted to a unique case.

### 2) U.S. Steel

The next significant ICA case stemmed from the government's 2007 approval of a US$1.9 billion acquisition of Stelco Inc. by the United States Steel Corporation ("U.S. Steel"). As is customary, the approval was conditioned on numerous legally binding undertakings made by U.S. Steel to the Minister (thirty-one undertakings, in this case).

In February 2009, the Investment Review Division of Industry Canada (the "IRD"), consistent with usual practice, requested a follow-up compliance report in respect of U.S. Steel's commitments, to be delivered in April. In March, U.S. Steel issued a press release announcing the closure of two mills (which amounted to substantially all the Canadian operations) and layoffs of approximately 1,500 employees. Neither the Minister nor the IRD was given advance notice of the announcement, and thus neither had the opportunity to prepare for the inevitable political fallout. Over the following months, the IRD concluded that U.S. Steel had failed to comply with two key undertakings on employment levels and production. Seventy-five percent of the 3,105 Canadian workers contemplated in its employment undertaking were not working, having been laid off or taken retirement packages, and, despite having committed to increase Canadian production by 10% in three years, U.S. Steel had essentially shut down its Canadian operations. The impact of the slowdown on the Canadian operations, the government noted, was disproportionate to the impact on U.S. Steel's United States-based operations, which were still running and receiving Canadian materials for processing and supplying Canadian customers.

In response to a formal demand letter requiring compliance or adequate justification for the alleged non-compliance, U.S. Steel argued, pursuant to guidelines issued under the ICA, that the non-compliance was due to factors beyond its control, including the devastating impact of the global economic crisis on the steel industry. Unsatisfied, the Minister filed a formal application with the Federal Court of Canada seeking a court order for compliance with the undertakings and payment of a monetary penalty of CDN$10,000 per day of non-compliance. The Minister declined to seek more extreme remedies open to him such as divestiture of the Canadian business, although a private litigant has intervened to argue the availability of that remedy. Also of note is that the United Steelworkers were granted intervener status to argue on the question of damages to their members.

The case has not yet been decided on its merits. A review of the government's pleadings in the U.S. Steel case suggests that, despite the existence of guidelines requiring the government to consider factors beyond the control of an acquirer when reviewing compliance with undertakings, the government perceived the case to be one of extreme non-compliance, with employment and production levels well below the levels promised in U.S. Steel's undertakings. Conversely, U.S. Steel argued that Stelco Inc. had been in creditor protection only a year before the acquisition was proposed, that the economic downturn was sudden and dramatic, and that it is likely that Stelco Inc. would have faced similar difficulties in the economic environment to those met by U.S. Steel. The government's claim suggests that it may be particularly concerned where negative economic effects are shared disproportionately between Canada and another country. It is our view that the U.S. Steel case arose out of an extreme, "worst case" factual scenario, with the government feeling compelled to take action.

### 3) The Potash Corporation of Saskatchewan

As an iconic world-class producer of a key Canadian natural resource, BHP's hostile takeover bid for Saskatchewan's PotashCorp attracted massive political and media attention from the moment of its launch in mid-August 2010.[3]

The Premier of the Province of Saskatchewan vigorously lobbied the federal government to refuse the proposed bid, concerned, amongst other things, about potentially significant negative tax consequences for the Province of Saskatchewan and the loss of a public company Canadian head office with a majority-Canadian board of directors.

On November 3, 2010, the Minister issued a preliminary decision rejecting BHP's bid on the basis that it failed to satisfy the ICA's net benefit to Canada test. Although the ICA provided BHP with a 30-day period within which further submissions could be made to try to change the Minister's view, BHP apparently chose not to submit further undertakings, officially withdrawing its application on November 14, 2010. BHP issued a detailed press release following the failure of the bid, outlining numerous specific commitments it had been prepared to make.[4] Undertakings would apparently have included a five-year commitment to remain in a Canadian potash export group, significant spending on infrastructure, increased investment in BHP's already planned Jansen mine (also located in Saskatchewan), commitments to forgo certain tax benefits and to apply for a listing on the Toronto Stock Exchange. Other proposed undertakings apparently related to employment increases, spending on community and education programs, and an unprecedented US$250 million performance bond to ensure the company fulfilled its undertakings.[5]

Following the decision, some commentators noted suggestions by Minister of Agriculture Gerry Ritz that BHP's bid had been refused because potash is a "strategic resource" for Canada.[6] While this is not an explicit factor for consideration under the ICA, it would not be unusual for a country to be protective of its most valuable resources or companies.[7]

Although the ICA rules certainly provide the Minister with significant discretion, the PotashCorp decision has led to calls for clarification of Canada's foreign investment rules from businesspeople, investors and politicians across the political spectrum. Critics of the ICA have cited a lack of transparency and a lack of predictability as factors affecting the efficacy of the ICA. While the current approach gives the Minister significant flexibility to assess proposed investments on a case-by-case basis, which is a positive feature of the regime, it is also true that perceived unpredictability might complicate the risk assessments undertaken by foreign acquirers and conceivably deter investment in Canada. Nevertheless, the PotashCorp decision had numerous unique features, including the absolute opposition of the Premier of Saskatchewan to the transaction, suggesting that, as with the MDA transaction and the U.S. Steel case, it would be incorrect to draw broader conclusions regarding Canada's approach to foreign investment from this small set of unusual transactions.

## Endnotes

1. Stikeman Elliott LLP acted as counsel to ATK.
2. 'Federal government blocks sale of MDA space division,' *CBC News* (10 April 2008) <http://www.cbc.ca/money/story/2008/04/10/mdablock.html> accessed 18 January 2011.
3. Stikeman Elliott LLP acted as counsel to PotashCorp.
4. BHP Billiton, 'BHP Billiton Withdraws Its Offer to Acquire PotashCorp and Reactivates its Buy-back Program' (Press Release, 15 November 2010), <http://www.bhpbilliton.com/bb/investorsMedia/news/2010/tonWithdrawsItsOfferToAcquirePotashcorpAndReactivatesItsBuybackProgram.jsp>; accessed 18 January 2011.
5. *Ibid.*
6. Steven Chase et al., 'Potash takeover failure blamed on billion dollar pledge requirement,' *The Globe and Mail* (15 November 2010), <http://www.theglobeandmail.com/news/politics/potash-takeover-failure-blamed-on-billion-dollar-pledge-requirement/article1800044/> accessed 18 January 2011.
7. In fact, Australia itself has been known to protect key industries and, at the same time that BHP was making a bid for PotashCorp, Australian authorities were engaged in a detailed review of the takeover bid for the Australian Stock Exchange by Singapore Exchange Ltd. Indeed, the very existence of BHP and the other Australian mining supergiant, Rio Tinto, as Australian companies, is due, in no small part, to the existence of stringent Australian foreign investment rules that played a major role in previous transactions involving BHP and Rio Tinto.

**Shawn C.D. Neylan is a partner in the Toronto office of Stikeman Elliot LLP. His practice focuses on regulatory reviews of transactions under the Competition Act and the Investment Canada Act. Mr. Neylan can be reached at sneylan@stikeman.com.**

**Michael Kilby is an associate in the competition law group in Stikeman Elliott's Toronto office. He regularly advises on all matters relating to Canadian competition and foreign investment laws. Mr. Kilby can be reached at mkilby@stikeman.com.**

# Should We Samba, Tango or Mambo? A Primer for Internal Counsel on Getting Started in Latin America

By Mary Rose Brusewitz

Anyone following Latin America over the last 20 years understands the meaning of "boom and bust." Periods of strong foreign investment in one or more countries have frequently been brutally stopped short by economic and political crises or massive restructurings in the sovereign and private sectors. Long-term stability has not been enjoyed by most of the nations. Until relatively recently, Latin America has taken a backseat in the strategies of many companies based outside the region. This has started changing.

Latin America is on the radar screen of clients. They may be considering selling their products in the region. Others may be weighing whether to enter into a joint venture or to make an acquisition or an investment in an existing entity. Still others want to investigate whether to create a presence in one or more countries.

Some clients are knowledgeable and positive about Latin America. Others are fearful due to political, security or legal risks. Emerging, developing and resource-based markets present challenges to investors. Expanding a business across any border, even a State line in the U.S., requires careful planning and skilled execution. I believe some negative experiences could have been avoided at least in part by undertaking more careful diligence and taking a different approach from the outset.

How can you help your clients prepare themselves to evaluate whether to expand into Latin America? This article is intended to help you support your clients in this effort.

## Latin America Is Multi-Faceted

Investors used to view Latin America as a homogenous zone. When one country suffered a crisis, investors fled the entire region. Nowadays, investors are savvier. Foreign investment in Latin America declined as the result of the global financial crisis but is now on the upswing.

In 2010, investment in some countries was quite active. Brazil was the number one recipient of investments, followed by Chile, Colombia, Peru, Mexico, Uruguay and Argentina. Mexico is viewed as complicated due to security issues and lack of re-regulation of the energy sector. Other countries like Bolivia, Ecuador and Venezuela are seen as risky due to factors like perceived political and economic instability, suspicion of foreign investment and / or lack of development of relatively predictable legal regimes.

In general, the legal systems are based on the civil code. However, the manner in which each legal and regulatory framework has developed is unique. Many countries have implemented more "modern" codes. But I have found that even modifications that seem to be similar include substantive and procedural details that can make a difference in practice. Picture someone saying that the laws and regulations must be the same or very similar in the U.S. and England because both countries have "common law" regimes. In practice, we know that the legal and regulatory systems in the two countries are very different. There are many features that the legal and regulatory systems in the region share in common; it is safer to assume that there are more differences than similarities.

## Cultural and Linguistic Awareness

Each Latin American country has its unique history, culture and political and social structure and institutions. Native speakers from one Spanish-speaking country can have trouble understanding people from another Spanish-speaking jurisdiction. Business and social customs differ widely. Many people from the region speak English fluently. It is not necessary to learn Spanish and / or Portuguese. It is advisable to learn to speak at least a few phrases, as a sign of interest and commitment. But developing sensitivity to cultural, social and linguistic nuances can enhance effective communication and be essential for success.

## Defining the Objective

The company's ultimate business objectives should be defined early. The objectives and how to achieve them will be refined as you proceed. Does the company wish to engage in transactions in the region as opposed to developing a presence there? Does it wish to market, promote, distribute and / or sell its products or services in one or more countries in the region? Does it want to appoint an agent or distributor? Is creating a physical presence to sell products or provide services important? Does the company want to acquire an existing company or do a joint venture with a player in the relevant market(s)? Does it want to open a branch or agency or create a subsidiary or affiliate? How will this decision be made?

The company will probably not be certain at the outset. Several options may need to be investigated. The company will want to undertake market research and establish contact with market participants within and outside the region. Key players at the company should travel several times to each potential target country.

The business proposition may evolve over time, but definition of the possible options can assist the team to ask the right questions and guide the process of analyzing the costs and benefits of each possible approach.

## The Team

The company needs a team of internal and external resources to evaluate any proposed expansion of the business into Latin America. Defining the strategy involves many areas of expertise, including: tax, accounting, finance, operations, human resources, compliance, risk management, insurance, legal and others. Background checks of potential targets, executives, partners, employees, agents or other parties whose cooperation or involvement will be needed. Securing access to people with appropriate expertise is a priority.

It is important to include all of the functions in the company that will eventually need to liaise to implement the strategy. The challenge is to determine when to include different functions in the process. Large teams can create inefficiencies. There is an understandable reluctance to get too many people fired up too early. It is always challenging to weigh carefully how much money and other resources to spend on a project when the chance of success and profitability is not clear. Including appropriate expertise in the process as early as is feasible can help avoid surprises and delays in implementation and prevent wasting of time, money and other resources.

## Involve Counsel Early On

If the company proposes to do business in another country, it will need to understand and comply with the laws of the other country. Internal or external counsel, or both, should start to be involved relatively early on. This is true whether products will be sold into the country, the company proposes to operate there or the company will make an investment into or a joint venture with a local company. Part of the analysis of whether it makes sense to expand into another country at all includes developing a view as to what the status of the rule of law is, whether foreigners can enter the relevant sector at all or under which restrictions, whether the business will be subject to specific regulations and in general what the legal and regulatory climate is like.

In my experience, a general understanding of the legal and regulatory environment is best achieved early on, so that concerns can be raised and factored into the mix. This is not to say that the company could not determine to expand into a country simply because challenging legal issues are spotted. Risks related to the legal and regulatory environment enter into the overall equation when projecting what it will be like to do business and what can be expected if things go wrong. There is no such thing as a jurisdiction that presents no regulatory risk. The idea is to identify the risks and minimize the possibility that costly or even "show-stopping" issues pop up after structures have been agreed, documents executed or commitments made. In addition, a framework to follow proposed and actual changes from time to time (even during implementation!) should be formulated.

## Information About the Legal and Regulatory Regime; In-Country and International Counsel

Some research on legal and regulatory systems can be undertaken from one's desk. Internet searches can locate information. Chambers of commerce are good sources of contacts and information. These organizations hold events that can provide valuable information and guidance. There are plenty of "doing business" guides and other sources of background information.

Communicating with internationally experienced lawyers that have worked in the region and attorneys admitted in the relevant countries will be necessary. Most of the time, some preliminary meetings with external counsel will be possible without "starting the clock."

Locating qualified in-country external counsel is a challenge if one has not already worked in the region. Contacts or colleagues can provide references. There are international networks of lawyers. Some international firms operate in the region. In nearly every country, there are a number of good options, large and small. Some firms are very well known to foreigners. Others may be lesser known internationally but may be well-suited and highly qualified. People frequently state that one hires lawyers, and not firms. You need to have confidence in the quality and reputation of each lawyer and firm.

I recommend interviewing a few lawyers at firms of different sizes and profiles. This gives you a range of options and an idea about how legal services are managed and priced. There may be conflicts, pricing issues, personality preferences or other impediments to working with one or more lawyers / firms so it is best to be broad early on. Some firms may be specialized in only one area that is significant for your company. You may consider retaining that firm for limited issues and one or more other firms for other issues. In many countries, tax or litigation expertise may not generally be found at larger firms. You may want to locate firms that can handle bookkeeping, payroll, immigration or other specialized services. The law firms with relevant experience will be able to assist you to find the right expertise and define the proper scope of work and contractual arrangements.

Management of the legal / regulatory diligence process requires time and perseverance. Most outcomes that can be achieved in your home country can also be achieved in most countries in the regions, but often via a structure that looks different and has some different attributes and consequences. It can take more than a few exchanges of emails and conference calls or meetings to completely be certain that you and the team understand the options and the risks and benefits of taking different approaches in structuring the implementation of your strategy.

## The Key Areas of Inquiry

I have included below a general list of some questions to start out asking when contemplating expanding into Latin America. It will be necessary to prioritize the questions and determine who on the team should pursue the inquiries. The list would need to be tailored for each country and to deal with issues that need special attention for each proposed strategy and business sector. This list does not comprise an exhaustive list or include all of the issues that may be relevant to this sort of exercise. It is intended to serve as general guidance.

- What is the general macroeconomic history and outlook for the economy in each target jurisdiction for the sector and business proposition? What trends and features stand out that need to be taken into consideration (such as inflation, and the like)?
- What is the political climate like and how stable is the political and economic landscape at all levels, national, state / provincial / departmental and municipal levels?
- What is the overall presence of the government in the economy generally and in your sector(s)? How strong is the private sector? Is the government directly or through controlled enterprises a major element in all or nearly all vital sectors of your industry?
- Are the political and economic realms relatively independent at the national, state / provisional / departmental and municipal levels? If the party or person currently in control were to lose power, would significant changes in the economic or regulatory framework occur?
- Is the currency stable and freely convertible? Is it over- or undervalued? How volatile is it? Are exchange controls in place? Is hedging necessary and if so is hedging affordable?
- How have our competitors fared? How did they structure their entry to the market(s)?
- Which cities and states / provinces / departments should we look at? Are tax or other incentives available?
- Is it safe to travel and work there? What security measures will be necessary?
- Is political risk insurance necessary or advisable?
- Can foreign investors participate in the sector? If so are there any applicable limits? Must the investment be registered? Are approvals for investments required? If so, how does the process work and what is the likely timing and cost? For some regulated industries such as banking and insurance, a license or other franchise may be required and this can take time and be quite expensive.
- Do local players have tremendous advantages such that a foreign entrant cannot hope to compete? Should the company consider doing a joint venture or buying a company already in operation or go it alone?
- How complex is the applicable regulatory framework? What is the interplay between / among national, state / provincial / departmental and municipal laws, regulations, courts and governmental or regulatory bodies? Are significant changes in any applicable framework pending or proposed?
- Do players in the industry actually comply with the applicable laws and regulations or is non-compliance tolerated? Can your company compete if others do not comply and your company does?
- Are antitrust or anti-competition laws relevant? What impact will these have on success of the strategy or on timing and costs of entry?
- How is the jurisdiction generally viewed in terms of "rule of law"? Are contractual obligations generally respected and enforceable through the courts or arbitration?
- How do the branches of government interact?
- Is the court system thought to be reasonably independent and fair?
- Are "prohibited practices" (i.e., bribery, corruption, etc.) seen to be widespread?
- Can the company compete if it does not engage in prohibited practices?
- What is the bankruptcy regime like? Is it "modern"? What has recent experience indicated?
- What are the labor laws like? How do they impact employees, officers, distributors, agents or other parties that might be involved if the company implements its plans? What are the "social costs" such as taxes, benefits or other similar items? Can parties be made redundant without a great deal of expense? Is membership in a union mandatory for any of the potential workforce, executive or otherwise? What does union membership mean for the ability to operate and set compensation?

- How is compensation generally paid to parties at the levels you may employ or contract with? Are there mandatory year-end bonuses? Is inflation adjustment mandatory or customary? Is there mandatory profit-sharing for any category of workers / executives?
- How complex is the tax regime? Are there thin capital rules? How does the transfer pricing regime work? What is the overall tax burden applicable to transfers of funds, profits / operation, remitting profits, etc.? Is there a single national regime or are there also state / provincial / departmental or municipal taxes?
- If intellectual property is key to the company's business, how do the laws in the jurisdiction work? Is intellectual property protection strong enough?
- How modern are the laws relating to creating entities? What are the options in terms of kinds of entities? Depending on the strategy, if an exit is part of the plan, what impact will choice of entity have? What are the laws and practices relating to corporate governance like?
- If officers, directors, managers or employees need to be brought from abroad, what is the immigration regime like?
- Are there applicable limits or taxes on transfer of profits abroad?
- Should investments be made or contracts signed by the offshore company or should an intervening entity be involved? Is there tax haven legislation that creates disincentives / causes penalties to apply depending on where investments are made from or where counterparties are organized?
- Depending on what kinds of contracts are contemplated, is arbitration a feasible alternative? Can one select a foreign law to govern certain contracts like shareholders' / quotaholders' agreements?
- To execute documents or take other actions, will the company need to grant powers of attorney to a local party? How can limitations on any powers of attorney be placed? What must be done to legalize documents executed offshore? If any matters need to be done on a tight time frame, getting to know how to "legalize" documents will be vital.
- What kind of liability do shareholders or directors have for taxes, social costs or other items? Does a holding or other intervening company need to be interposed to shield the parent company from liabilities?
- What kinds of insurances need to be put into place? Will international policies provide adequate coverage? Will policies need to be contracted locally to comply with laws?

## Conclusion

This is an exciting time to consider expanding into Latin America. The legal and regulatory dimension is a significant part of any cross-border strategy. In order to see if this is right for your company, improve the chances of success and avoid costly surprises and mistakes, your contribution to an organized approach will be important.

**Mary Rose Brusewitz is a partner at Strasburger & Price, LLP, where she concentrates her practice on Latin American transactions—most recently in Argentina, Bolivia, Brazil, Colombia, the Dominican Republic, Mexico, Nicaragua, Perú and Venezuela—as well as Spain and Portugal. Ms. Brusewitz represents major Latin American companies as well as U.S., European, and Asian entities doing business in Latin America and elsewhere. She can be reached at maryrose.brusewitz@strasburger.com.**

# Issues That U.S. Corporate Counsel Should Consider When Doing Business in Guatemala

By Alexander Aizenstadt L.

As reported in The New York Times, “Central America’s 45 million consumers buy more U.S. products than the 1.5 billion people in India, Indonesia, and Russia combined.”[1] With Guatemala itself accounting for about one third of the total population in the region, it is not surprising that U.S. companies have an interest in this consumer and labor market just a short 2 ½ hour flight from Miami. In fact, there is a rich tradition of U.S. business interests in Guatemala.

After spending many years working together with foreign counsel on how to protect their clients´ legal interests in Guatemala and having lived and studied in the U.S., I can say that the following are some of the most important issues that corporate counsel should take into consideration when doing business in Guatemala.

## I. Guatemalan Business Culture

Most lawyers doing deals in the country will find that Guatemalans are hard-working and business savvy. Although some meetings can be relaxed, usually business meetings are serious affairs. Formal business attire and punctuality is expected. In contrast, social events tend to be more relaxed and punctuality is not the norm. In business, it is normal to address people by their professional titles (i.e. *Licenciado/a* is used to address Attorneys). As in many other Latin American countries, complete names are frequently comprised of a first and middle name and two family names, usually the paternal family name followed by the maternal family name (i.e., Juan Carlos López Valenzuela). To formally address someone typically one uses his or her title and only the first of his or her last names (i.e., *Licenciado* López). Married women will use a first name and the prefix “*de*” followed by their husband´s family name (i.e., Monica de López). This is generally the norm but as always there are exceptions. Addressing somebody by their title and their first family name is expected for business correspondence. However, legal documents should include all names.

Once you have met someone, in many cases, you may refer to them by their first name. Relationships are very important in Guatemalan business culture, therefore social conversation usually takes place before or after serious business. Particularly within long-term business relationships it is common to get invited to social events and to meet or inquire about each other’s family.

In the context of large deals with foreigners, English is usually the language of negotiation; it is also the language in which the final documents are drafted. Only once did I encounter a local bank that was reluctant to draft a major deal in English. Local courts will enforce a contract drafted in any language if a certified Spanish translation is provided. However, some documents have to be drafted in Spanish, especially ones that require registration before the local authorities (like real estate transfers and articles of incorporation). In communicating with others outside of the meeting room, you may get along in English in hotels in the capital and in the main tourist sites (Antigua, Atitlan, Tikal, etc.), but apart from these areas you will most probably need to speak in Spanish.

The local currency is the quetzal but dollars are very often accepted.[2] Deals can be conducted or indexed to any foreign currency without restriction. Generally, even purely local agreements dealing with large assets, such as real estate or rental agreements are fixed in or indexed to the dollar. Local bank accounts can be set up in local currency, dollars and in some cases, Euros. There are no restrictions on conducting business in dollars, nor are there limits on currency exchange or repatriation. However, there are newly implemented limits on handling cash deposits and withdrawals at banks, though note that these are mainly directed at preventing money laundering.[3]

Newcomers often find it surprising that Guatemala City has a modern and business-friendly atmosphere. Most business deals take place in the capital. The infrastructure, hotels, telecommunications and banking industry generally are sufficiently sophisticated for the purposes of cross-border business. Crime rates are high so you should always take precautions.[4]

## II. Dealing with the Government

Whether it’s a trademark registration, the recording of a power of attorney, or securing a mortgage over land, many business activities require dealing with the government. It is particularly on these aspects that you will need local counsel. Government offices and registries are centralized in the capital. Some documents, and in particular those that will be recorded, such as land transfers and articles of incorporation, are drafted in Spanish on special paper (*escritura pública*) available only to notaries.[5] In these notarial documents, the original is kept by the notary who may issue certified copies. If confidentiality is an issue, keep in mind that notaries are legally required to send a copy of these documents to a registry where they are available to the public.

Some documents and in particular those that will need to be recorded, including foreign powers of attorney, are only valid in Guatemala once they have passed through a lengthy consular legalization process. It is important to note that Guatemala is not a party to the Hague Apostille Convention.[6] This means that unlike other jurisdictions the legalization process will take some time. A few years ago, a foreign in-house counsel for a financial institution called me in order to consult on whether a shareholders´ meeting could be scheduled to take place later that week. I explained that in this case the proxies had to be notarized in the country of execution, legalized at the Guatemalan consulate, sent to my office, legalized at the Foreign Relations Ministry, recorded at the General Notarial Registry and at the Commerce Registry. Needless to say, the shareholders´ meeting had to be postponed.

Once a request has been submitted at a government office or court on any matter it is indispensable to have an experienced professional ensure that the process runs its due course. On one occasion I found out that a client's request for a permit at the Finance Ministry had been delayed because the clerk had left for vacation and the documents were locked in her desk. Although some institutions have undergone substantial modernization and can provide timely results, you should always be prepared for substantial delays, holidays or requests for new documents. Even the most specialized and experienced practitioners can't ensure that a process will be complete by a set date, so always consider leaving some time available for unforeseen delays.

## III. Limitations for Foreigners

In addition to domestic regulations, U.S. companies are granted the protections afforded by the U.S.–Dominican Republic–Central America Free Trade Agreement (DR-CAFTA), in effect for Guatemala since July of 2006.[7] The agreement contains the usual protections regarding national treatment, compensation for expropriation, most favored nation, minimum international standards and others.[8] So far only one case has been filed against Guatemala by a U.S. company.[9] The arbitral award has not yet been issued.

In general terms, foreigners have the same rights as nationals when it comes to business.[10] It is only if you are involved in certain specific activities that you might find that a distinction is relevant. Foreign investment requires no registration and there are no limitations for repatriation of earnings. Most limitations for foreigners involve the prohibition on owning certain lands, including some government lands;[11] land located in the national borders, and in the shores of navigable rivers and lakes.[12] Activities in the forestry industry and other regulated sectors like banking and insurance might also present some restrictions.[13] In addition, foreign institutions are barred from receiving inheritances.[14] Other relevant limitations include the protection of Guatemalan workers: therefore, if you are setting up shop in the territory consider that 90% of all employees must be nationals and the sum of their salaries should account for at least 85% of the total payroll.[15]

It is important to consider that some limitations might be the result of practice rather than law. For example, in one case the delivery of a money judgment to a foreign client was delayed for a few days because the Tribunal had to file for a temporary tax number on behalf of the company. In many cases, limitations on foreigners´ activities become irrelevant where a local company is incorporated.

## IV. Incorporating into a Local Company

There are no limitations on foreign ownership or control of local corporate entities. A locally incorporated company requires a minimum capital balance of Q. 5,000.00 (U.S. $627.00)[16] and following a procedure at the Commerce Registry that can take up to a month to complete. Some fees and taxes will also be applicable. After this, a separate registration process before the Tax Authority will be necessary. However, companies can begin to operate temporarily before the process is complete. In general terms, there are no readily available off the shelf companies. If you happen to find one, always be wary of the previous liabilities it may have acquired in the past.

The most common corporate entity is the *sociedad anónima*. It allows for limited liability and unlimited duration. Note that some features of the *sociedad anónima* will change in the following two years due to legislative amendments.[17] Once a company has been established corporate formalities or fees are minimal, but there are some periodic tax documents that should be filed regularly.

Many business activities carried out by foreign companies do not require specific registration as a foreign company nor be incorporated as a local company. Some of these activities include acquiring title over land, registering trademarks, and taking part in litigation or lending money.[18] In my experience the registration of a foreign company is quite uncommon and generally related to foreign companies involved in government procurement. In cases where registration as a foreign company is required, the process can take up to a month and requires the subscription of a US$50,000 bond.[19]

## V. Intellectual Property

Guatemala has relatively modern IP legislation and is party to several international agreements, including the Patent Cooperation Treaty,[20] the Rome Convention,[21] the Paris Convention for the Protection of Industrial Property,[22] and TRIPS.[23] Additional protection for U.S. companies is afforded by DR-CAFTA: the IP provisions of this treaty have been described by the U.S. Advisory Committee for Trade Policy and Negotiations as "the best that have been negotiated in any U.S. trade agreement."[24]

All IP matters are handled by the Intellectual Property Registry. The Registry received about 7,400 trademark applications during 2009, more than two-thirds of which were owned by foreign companies.[25] The trademark registration process typically takes between 10 to 12 months and grants protection for 10 years, at which time the protection is renewable.[26] Protection dates back to the filing date. Registration, defense or opposition can be handled by an attorney by means of a proxy in Guatemala. A patent for an invention is protected for 20 years and takes about 2.5 to 3 years to obtain.[27]

## VI. Labor

Labor issues are regulated by a specific set of rules outside of the scope of general contract law. There is no at-will employment and individual labor disputes cannot be submitted to general arbitration. Guatemala recognizes the creation of labor unions and provides protection for the negotiation of collective bargaining agreements. However, it is unusual for small and medium-sized companies to have a union.

Minimum wage is fixed by the government on a yearly basis. For 2011 it has been set to Q.63.70 (U.S. $8.01) a day for all sectors, except for the export and confection industry which has a lower salary of Q.59.43 (U.S. $7.47) a day.[28] The usual work week consists of 5 or 6 working days, 8 hours a day, and no more than 44 hours a week.[29] Overtime is paid at a 50% increase over the normal hourly rate.[30] Fifteen days vacation leave is mandated.[31] In addition, the Guatemalan calendar year has about 12 holidays.[32] Most recently Congress approved a law stating that if a holiday lands on a Tuesday or Wednesday the employee is also entitled to take off the previous Monday. If the holiday lands on a Thursday, employees take off Friday in order to enjoy an extended weekend.[33]

Employees are entitled to 14 monthly wage payments a year, corresponding to 12 monthly salary payments plus a Christmas[34] and mid-year bonus.[35] Employees are also entitled to a minimum performance bonus[36] and social security, among other benefits.[37] In case an employee is fired without cause, he or she is entitled to receive severance pay equal to one monthly salary for every year of employment, plus 30% as economic benefit.[38] An employee can be fired without severance pay only if it is with cause or during the first two months of the employment.

In general, it is very important to maintain well prepared written agreements with all employees; otherwise the courts will apply a presumption in favor of what is stated by the employee.[39] Counsel for a U.S. company should also be aware that even if the company has an agreement with a local independent contractor or distributor stating that it is not a labor agreement, if it meets the general conditions of a labor agreement, a local labor court might consider it an effort to conceal an underlying employment relationship and enforce it as such.

## VII. Taxes

Taxes are a complex and industry-specific matter. Guatemala does not have any double taxation agreements with the U.S. The fiscal year begins on January 1st and ends on December 31st. Income tax is charged on earnings from national sources only. When registering before the National Tax Authority companies can choose as to whether they pay 5% of gross income or 31% of taxable income.[40] Personal income tax for individuals depends on a bracket that goes from 15% to 31% of taxable income. Professionals may, however, elect to pay 5% of gross income as an alternative.[41] Capital gains are also taxed.

Some foreign industries like transportation, film production companies, insurance and news agencies have specific taxation brackets.[42] There are also many industry-specific taxes, for example, on the distribution of cement, petroleum and alcoholic beverages.[43] A "Solidarity" Tax may also be applicable on commercial activities that generate profits over 4% of gross income. This tax is about 0.25% of the larger between assets or income, but can in some cases be deducted from income tax contributions.[44] A value added tax (VAT) is applicable on most sales, including land transfers and is equivalent to 12% of the sale price.[45] There is an annual tax for the circulation of vehicles which is 1% to 0.1% of the value of the vehicle, depending on the year model.[46] Annual property taxes are about 0.9% of the registered value, but most properties have a commercial value that far exceeds their registered value.[47]

Central American regional agreements will also offer advantages for products made in Guatemala. Additionally, there are several operating Free Trade Zones (FTZ) in which companies are exempted from paying import and export duties.[48] Many apparel shops have taken advantage of this scheme in order to import raw materials and export manufactured goods into the U.S. FTZ´s can also be advantageous for other activities, like call centers and factories. A few years ago I even advised a foreign client on how to set up a refrigerated fruit export business in an FTZ.

## VIII. Dispute Resolution

As a general rule I advise my clients to avoid litigation in Guatemala. A judicial procedure can often be a lengthy and costly affair. A regular contract dispute takes between 4 and 6 years in order to reach a final judgment, sometimes even more. Bankruptcy procedures can take decades. If you do have to file a suit, the courts in the city are more accustomed and equipped to deal with complex matters than those in the provinces. If you need to serve process outside of the country, it will entail a prolonged letter rogatory procedure.

In general terms, Guatemalan law allows for the parties to establish the courts of another country or arbitration as the forum for dispute resolution. In many cases, the laws of another jurisdiction can also be set as the law of the contract. Contracts dealing with large sums will often include an arbitration clause. Our arbitration law is based on the UNCITRAL model law.[49] For international deals it is common to select Miami or New York as the seat of arbitration. The American Arbitration Association (AAA) or the International Chamber of Commerce (ICC) rules are common for these types of deals. There are a few national arbitration centers as well, but they handle only a few cases a year and are subject to the delays that might arise from legal action filed before the national courts.

It is important to remember that even if the forum for dispute resolution is set outside of Guatemala, the final judgment will eventually have to be enforced by local courts. Even though Guatemala has been a party to the N.Y. Convention since 1984, it has been my experience that the enforcement of foreign awards can sometimes be a substantially lengthy ordeal.[50] Although some awards can be enforced within one or two years and orders for attachments obtained over assets, I know of at least one case in where enforcement of an arbitral award rendered in the U.S. has taken over nine years.[51] Therefore, when the deal is made you should take care to ensure contractual provisions give you an advantage and help you reach a negotiated settlement if a future dispute should arise.

## IX. Local Counsel

One of the most important decisions you will make is selecting local counsel. Always have a written agreement and be clear about your expectations from the beginning. It is essential to clearly define the services that are covered, otherwise you might be liable for additional fees that are contained in a statute.[52] Be wary that some practitioners have very relaxed standards regarding conflicts of interest. National ethics regulations are not nearly as detailed or strict as the ABA Model Rules on Professional Conduct and ethics boards are not as effective.

Most lawyers will work with either hourly fees or fixed rates, and in dollars. It is always advisable to obtain an estimate of total billable hours in advance. You will find that most law firms are located in Guatemala City. It will be harder to find qualified English speaking counsel in the provinces.

The legal market is small and law firms range from sole practitioners to firms with 30 lawyers. There are no local branches of U.S. firms. Most attorneys handle a wide array of fields. There is no high degree of specialization, except in areas like Family or Criminal Law. Many practitioners are also litigators. There are many qualified attorneys in Guatemala accustomed to protecting the interests of U.S. clients, although only a few with degrees from abroad and only a handful have been admitted to a U.S. State Bar. With this in mind, with some diligent searching, you are sure to find a partner in Guatemala that will assist you with a high degree of efficiency and integrity.

By following these recommendations and taking some time to understand the unique characteristics of Guatemala´s culture and regulation, you will be able to successfully represent your client´s legal interests when doing business in the "land of eternal spring."

## Endnotes

1. Lionel Beehner, *Q&A: The CAFTA Debate*, N.Y. Times, July 8, 2005, http://www.nytimes.com/cfr/international/slot3_071805.html (This data also included the Dominican Republic).
2. The currency exchange rate at this moment is about US$1.00 = Q.8.00, but fluctuates constantly. *See* the Bank of Guatemala, http://www.banguat.gob.gt/cambio (last visited Jan. 20, 2011) (in Spanish).
3. Monetary Board Resolution, No. JM-108-2010 (2010), http://www.sib.gob.gt (last visited Jan. 21, 2011) (In Spanish) (Regulation applicable to cash transactions over US$3,000).
4. *See, e.g.*, International Crisis Group, Latin America Report No. 33, *Guatemala: Squeezed between Crime and Impunity* (2010), http://www.crisisgroup.org.
5. All attorneys in Guatemala are also notaries.
6. Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents. Oct. 5, 1961.
7. The Dominican Republic–Central America–United States Free Trade Agreement (DR-CAFTA), July 1, 2006, http://www.ustr.gov (last visited Feb. 2, 2011).
8. *See id.* Section 10.
9. *Railroad Development Corporation v. Republic of Guatemala.* ICSID Case No. ARB/07/23 (2007-2008), http://icsid.worldbank.org (last visited Feb. 2, 2011) (The case has not yet reached a decision on the merits.).
10. Foreign Investment Law, Decree No. 9-98, § 3 (1998).
11. Law for the Adjudication, Holding and Use of Land in Petén, Decree No. 118-96 (1996) and Supplementary Titles Law, Decree No. 49-79 (1979).
12. Const. §§ 122-123.
13. *See e.g.* Const. § 126 (forestry), Insurance Activities Law, Decree No. 25-2010 (2010) (insurance); Banking and Financial Groups Law, Decree No. 19-2002, § 6 (2002) (Banks).
14. Civil Code, Law-Decree No. 106, § 926 (5). (1973) A few years ago I petitioned the Constitutional Court to declare that this limitation was discriminatory; the Court however held that it was a distinction within the powers of Congress. *See* Constitutional Court. General Unconstitutionality. *Najman Alexander Aizenstatd.* File No. 534-2007. Judgment of April 10, 2008.
15. Labor Code, Decree No. 1441, § 13 (1961).
16. This is equivalent to US$627.00 as of 20 January 2011. *See* the Bank of Guatemala, http://www.banguat.gob.gt/cambio (last visited Jan 20, 2011) (in Spanish).
17. Extinction of Domain Law, Decree No. 55-2010, §§ 71-74 (2010).
18. Commerce Code, Decree No. 2-70, § 220 (1970).
19. *Id.* §§ 221- 215(5).
20. Patent Cooperation Treaty, Oct. 14, 2006.
21. International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations, Jan. 14, 1977.
22. Paris Convention for the Protection of Industrial Property, Aug. 18, 1998.
23. The Agreement on Trade Related Aspects of Intellectual Property Rights administered by the World Trade Organization, 1994.
24. Advisory Committee for Trade Policy and Negotiations, Report to the President, the Congress, and the United States Trade Representative on the U.S. Central America Free Trade Agreement (2004), http://www.ustr.gov (last visited Feb. 1, 2011).
25. *See generally*, Intellectual Property Registry, http://www.rpi.gob.gt (last visited Jan. 20, 2011) (in Spanish).
26. Industrial Property Law, Decree No. 57-2000, § 31 (2000).
27. *Id.* § 126.
28. Presidential Accord No. 388-2010 (2010).
29. Const. § 102(g).

30. Labor Code, Decree No. 1441, § 121 (1961).
31. *Id.* § 130.
32. *Id.* § 127. (January 1st [New Year]; Holy Thursday, Friday and Saturday [Easter]; May 1st [Labor Day]; June 30th [Armed Forces Day]; September 15th [Independence Day]; October 20th [Remembrance of the Revolution]; November 1st [All Saints Day]; midday December 24th , 25th and 31st; and the local patron's day in each province).
33. Promotion of Internal Tourism Law, Decree No. 42-2010, § 2 (2010).
34. Law that Regulates the Christmas Bonus, Decree No. 76-78 (1978).
35. Annual Bonus for Employees in the Public and Private Sector Law ("*Bono Catorce*"), Decree No, 42-92 (1992).
36. Performance Bonus Law, Decree No. 37-2001 (2001).
37. Organic Law of the Guatemalan Institute of Social Security, Decree No. 295 (1946).
38. Labor Code, Decree No. 1441, §§ 82, 90 (1961). (Economic benefits are understood as anything provided to the employee in addition to his or her salary, such as parking, meals, insurance and others. Unless it is otherwise agreed, benefits are fixed at 30% of salary.).
39. *Id.* § 30.
40. Income Tax Law, Decree No. 26-92, §§ 44, 72 (1992).
41. *Id.* § 43.
42. *Id.* §§ 34-36.
43. *See, e.g.*, Specific Tax on the Distribution of Cement Law, Decree No. 79-2000 (2000); Tax on Distribution of Distilled Alcoholic Beverages and other Distilled Beverages Law, Decree No, 21-04 (2004); Specific Tax on Distribution of Isotonic Carbonated or Sports Beverages, Juices and Nectars, Yoghurts, and Concentrated or Powdered Preparations for the Production of Beverages or Natural Bottled Water Law, Decree No. 09-2002 (2002); and Tax on Distribution of Law Petroleum and Fuels Derived from Petroleum Law, Decree No. 38-92 (2002).
44. Solidarity Tax Law, Decree No. 73-2008 (2008).
45. Income Tax Law, Decree No. 27-92, § 10 (1992).
46. Tax on Circulation of Terrestrial, Maritime or Aerial Vehicles Law, Decree No. 70-94, §§ 10-11 (1994).
47. Sole Tax on Immovable Assets Law, Decree No. 15-98, § 11 (1998).
48. Free Trade Zones´ Law, Decree No. 65-89 (1989).
49. Arbitration Law, Decree No. 67-95 (1995).
50. New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 19, 1984.
51. *See North American Energy Services v. Generadora Eléctrica del Norte, Ltda.* Constitutional Court. File No. 877-2003. Judgment of August 11, 2003.
52. Schedule of Fees for Attorneys, Arbitrators, Solicitors, Powers of Attorney, Experts, Administrators and Depositaries, Decree No. 111-96 (1996) and Notarial Code, Decree No. 314, Title XV (1946).

**Alexander Aizenstatd is a practicing attorney in Guatemala with a Master's degree from Yale Law School. He has also been admitted for the practice of law in the State of New York. He is a former fellow at the Max Planck Institute for International Law in Germany and teaches International Investment Law at Universidad Rafael Landivar. Email: najman.aizenstatd@aya.yale.edu. The foregoing should not be relied on as legal advice. Insightful comments by Ilona Roze, Esq., and Rebecca Engel, Esq. are acknowledged by the author.**

# One Step Ahead: Selected Immigration Issues for Corporate Counsel

By Sarah Pelud

Most companies today view the world as their marketplace, both from a sales perspective and an employee-recruiting perspective and as such, to ensure a company's success, the global mobility of personnel is more important than ever. However, when conducting business abroad, be it the recruitment and hiring of foreign workers or the business visit of an executive, businesses must be extremely careful to comply with all applicable immigration laws in order to avoid bad publicity, hefty governmental fines, civil and criminal sanctions, and a multitude of other adverse consequences.

Below are five (5) very different, but very real, immigration issues affecting U.S. businesses competing in today's global business environment.

## I. Sponsoring Foreign Workers—General Considerations

The most obvious and traditional concern when one thinks of business immigration is the timely procurement of visas and work authorization for foreign resources. The actual process of obtaining a U.S. work permit is technical, tedious, time-consuming, and sometimes subject to annual quotas. This is why it is important to work hand-in-hand with immigration counsel to ascertain not only the appropriate visa category but also the employer's obligations, the timelines, and associated costs before making offers and promises; this is especially true in today's environment of increased audits and investigations of employers.

Consider this scenario: The Human Resources Manager of a U.S.-based multinational company receives a stellar candidate to fill the position as Chief Financial Officer to work out of the company's U.S. headquarters. The candidate is a foreign national with extensive experience at a competing European company. Interviews have been conducted and an offer is made, and finally accepted. The company's board of directors and management are anxious to have the foreign hire join the team in the U.S., and in order to augment the company's image, the marketing department decides to release an announcement of the new appointment on the company's website. The HR department contacts outside counsel to begin the immigration paperwork to secure a proper work visa. Outside counsel returns with the news that in this case, the H-1B is the only visa category available and unfortunately all visa numbers have been used up for the current fiscal year, so the new CFO can only begin work in the U.S. on October 1. In addition, when the company then inquires about whether their new CFO can at least visit his new employer in the U.S., immigration counsel returns with a response that is less than reassuring.

This example highlights the importance of considering immigration issues early on in any foreign recruitment process. Also, the company must refrain from making any sort of public announcement with regards to a new assignment or position being accepted by a foreign national, including of course any website publications, until the actual visa has been approved. Here's why: most of the time when clients find out that it will take, at minimum, a few weeks to a month to obtain all the documents and visas to allow the new hire to legally begin working in the U.S., the next question is immediately, well can he visit the U.S. in the meantime? The answer is yes, he can *visit* and partake in normal business visitor or tourist activities but he cannot, under any circumstances, begin working for the petitioning entity in the United States in his new position. It is common knowledge that immigration officers will use the Internet and even Social Media to cross check information reported to immigration authorities. If a Google search of the applicant's name generates a news release or a LinkedIn profile, naming the applicant as the new CFO of a U.S. company, then the chances of him gaining entry as a visitor dwindle to next to nothing.

## II. B-1/VWP Misuse

In addition, companies must be vigilant not to misuse the B-1 Business Visitor visa (or entry under the Visa Waiver Program (VWP) for those foreign nationals exempt from obtaining a visa). B-1 or VWP visits are permissible only for a limited number of business-related activities, including meetings or consultations with business associates, attendance of a business convention or conference on specific dates, or to negotiate a contract. Its limitations should be respected. B-1 visitors have been refused entry upon inspection by an immigration agent at U.S. customs for a myriad of reasons, including simply possessing certain documents such as resumes and business cards listing a U.S. address which suggest that the purpose of their trip is different from the official story. Such documents should not even be stored on the B-1 visitor's laptop, as their laptops are subject to inspection as well.

Misuse of the B-1 / VWP category creates a very real risk to the individual applicant, as well as to the inviting U.S. business entity. If the applicant is determined to have fraudulently misrepresented his intentions, he could, at best, be turned away and sent home and, at worst, he could be served with a **lifetime bar** from the United States. Misuse of the B-1 also harms an employer's reputation and increases scrutiny of the company's valid B-1 applications in the future. U.S. employers should think twice before approving trips for foreign nationals to enter on a B-1 visa when the scope of their activities actually falls outside the purview of B-1 authorized activities.

## III. H-1B/LCA Compliance

More often than not, it is worth the wait to obtain the proper work authorization rather than authorizing the travel of "stealth" employees in B-1 status. Businesses have a variety of visa options for foreign nationals. One that is frequently utilized by businesses at a professional level is the **H-1B visa**. This category permits a qualified foreign national seeking to fill a professional occupation in the United States to be granted temporary H-1B status, normally for up to six (6) years. Each fiscal year, a total of 85,000 H-1B Work Visas are allocated. H-1B visas numbers go quickly, and although the demand has slowed significantly over the last couple of years, numbers have still been consistently exhausted before the end of each fiscal year.

What is important from an employer's compliance perspective is that as part of the H-1B application process, the sponsoring business seeking to employ a foreign national in H-1B status must post and submit a Labor Condition Application (LCA) to the U.S. Department of Labor. The LCA attests to a number of wage and working conditions, including:

- the wage offered to the foreign application is at least as high as that paid by the employer to current employees in the same or similar positions;
- the offered wage equals or exceeds the prevailing wage for the job in the same geographical areas;
- working conditions will not adversely affect similarly employed workers;
- there is no strike or lockout; and
- notice of the LCA has been given to current employees.

Employers are required to post the LCA for ten (10) days in two conspicuous locations at *each and every worksite* where the H-1B worker will be employed, including client sites. Employers are additionally required to maintain a public access file (PAF) for each employee in H-1B status, containing certain information regarding the foreign employee's wages and the employer's compliance with the LCA.

Essentially, it boils down to the fact that there are multiple compliance issues when sponsoring a foreign national for H-1B status (and for any visa status for that matter). The employer's obligations must be taken seriously as an unannounced visit from a Fraud Detection and National Security (FDNS) agent could take place at any time.

USCIS created The Fraud Detection and National Security (FDNS) Directorate which in turn created and implemented the Administrative Site Visit and Verification Program (ASVVP) in July 2009 as part of its ongoing enhancement to the integrity of the immigration benefit process. Under the ASVVP, FDNS conducts unannounced pre- and post-adjudication site inspections to verify information contained in certain visa petitions including H-1Bs as well as L-1s (Intracompany Transferees) and others.

Typically, an FDNS assessment consists of an unannounced visit of a FDNS agent or independent contractor, who may ask for a tour of the employer's premises, to examine the FN's work area, and to speak with the FN and/or his or her manager. Sometimes photographs are taken and document requests are made. The documents that an agent may request include, but are not limited to, local licenses, occupancy permits, fire code certifications, business leases, end-user contracts, LCAs, W-2s for all employees, corporate tax records and even resumes and degrees for the foreign national and all workers holding similar positions. Site visits by an FDNS agent can be time consuming and costly if the employer is not prepared, thereby making it is essential that U.S. businesses understand their obligations and document retention requirements when sponsoring foreign employees.

## IV. Employment Verification

It is old news that employers must verify the eligibility of their employees to work in the United States by completing the I-9 (Employment Eligibility Verification) form. However, what *is* news is that in the last year, ICE has leveled a record number of civil and criminal penalties against employers under Section 274A of the Immigration and Nationality Act, ranging from steep fines for paperwork violations to prison time for willful violators.

As part of the Obama's Administration's effort to thwart illegal immigration, ICE will continue to audit employers' I-9 records, imposing penalties not only on the "bad employers"(those who knowingly hire illegal workers) but also on those employers who act in good-faith, but nevertheless unknowingly completed an I-9 form improperly or failed to retain records, as required by the law.

To illustrate just how hard the current Administration is going after employers, in fiscal year 2010 ICE conducted 2,746 worksite investigations and imposed nearly $7 million in fines. Compare this to 1,191 investigations and approximately $675,000 in fines during the final year of the Bush Administration.[1]

The stated reason behind this crackdown is to attack the root-cause of illegal immigration: the willingness of some U.S. employers to hire illegal aliens. However, as a result, even "good" employers can also be found in violation and subject to hefty penalties.

On February 18, 2011, ICE announced the launching of yet another massive I-9 audit initiative, issuing 1,000 notices of inspection to employers. So there's more to come.

Moreover, in addition to the increased frequency of audits, the penalties imposed upon non-compliant companies have increased. A company could face a fine of up to $10,000 per *each* ineligible employee and a fine of up to $1,000 per *each* failure to maintain appropriate documentation. Managers and business owners may also be criminally liable for I-9 violations. A business owner may be jailed for up to six months for *each* unauthorized employee and can face up to five years in jail if he or she makes false statements concerning the I-9 documentation.[2]

These statistics, as well and the recent initiatives, are a flashing red light to employers, of all sizes and across all industries, to stop and take the time to ensure strict I-9 compliance by implementing company-wide I-9 systems and conducting internal audits on a routine basis.

## V. Immigration and Export Controls Compliance

Finally, immigration authorities are now verifying the compliance with not only their regulations, but those of other government agencies as well. On February 20, 2011, all petitioners of foreign non-immigrant workers, even those entities not typically involved with technology subject to U.S. Government export rules, became required to make an export control compliance statement to USCIS. The statement, made under penalty of perjury, is to certify that the foreign employee will not be allowed access to controlled U.S. technology or technical data until all applicable export licenses have been obtained (a/k/a "deemed export" rule). While the underlying deemed export rule remains unchanged, this is the first time that employers sponsoring non-immigrant workers are required to formally certify their licensing requirements to USCIS.

Export controls exist to protect U.S. national security and foreign policy interests. They govern the shipment, transmission, or transfer of certain sensitive items, including technical data and software, to foreign persons or entities. Sharing such controlled data with a foreign national, even inside the United States, is considered to be a "deemed export" which requires a U.S. Government export license. The technology at issue is identified on the Export Administration Regulations (EAR) Commerce Control List (CCL) and the International Traffic in Arms Regulations (ITAR) U.S. Munitions List (USML). The Department of Commerce, Bureau of Industry and Security (BIS), administers the EAR. The Department of State, Directorate of Defense Trade Controls (DDTC), administers the ITAR.

To certify that a license is not required in order to release controlled technology or technical data to a foreign national, the employer must carefully review the Bureau of Industry and Security's Commerce Control List (CCL) and the Directorate of Defense Trade Controls' U.S. Munitions List (USML). Employers must classify their own technology and technical data in the CCL or USML or conclude that their technology or technical data does not appear on either list. In addition, employers are required to classify technology or technical data generated by third parties (i.e., customers and vendors), if that technology or technical data is in the possession of the employer and may be accessible to the foreign employee. Employers should not underestimate the time and resources that will be required to review the CCL and USML.

While the lists, not surprisingly, identify a wide range of defense-related components as controlled technology, they also identify certain types of cameras, machine tools and even life jackets and protective shoes among restricted technology.

It is remains to be seen exactly how USCIS will process employers' export control certifications. However, one can safely presume that there will be information sharing with other U.S. agencies and increased enforcement, especially given that on November 9, 2010, President Obama issued Executive Order 13558 establishing an "Export Enforcement Coordination Center" within the Department of Homeland Security (which oversees USCIS operations) to facilitate information-sharing about suspected violations of U.S. export controls and to coordinate efforts to investigate and penalize violators.[3]

Civil penalties for non-compliance can range upwards of $250,000, or an amount that is twice the value of the transaction that is the basis of the violation. Criminal penalties for export violations are even more severe, including fines of up to $1 million and imprisonment for up to 20 years.[4]

It is therefore more important than ever for petitioners of non-immigrant workers to exercise due diligence with regards to their existing export compliance procedures and must familiarize themselves with the export control regimes to determine a method for analyzing and responding to the new questions.

## VI. Conclusion

From the outset, businesses must accept that immigration compliance is much more than filling out paperwork to obtain a visa or work authorization. Immigration issues inevitably seep into a wide variety of business matters and require an employer to prepare, report, and maintain information in cooperation with a multitude of government agencies, including, but not limited to, the U.S. Department of Homeland Security, Department of Labor and Department of State. Companies sponsoring foreign workers must be well-equipped to comply with all of their immigration obligations in order to avoid bad publicity, steep fines and even criminal sanctions. The duties are complex and heavy, but an inevitable burden that employers must tackle head on in order to compete and succeed in today's global business environment.

## Endnotes

1. ICE Worksite Enforcement—Up to the Job: Hearing on Worksite Enforcement Before the U.S. H.R. On the Judiciary, Subcomm. On Immigration Policy & Enforcement, 112 Congress. 1-2 (2011) (statement of Kumar Kibble, Deputy Director, ICE).
2. 274 INA § 274A, 8 U.S.C. 1324(a).
3. Exec. Order No. 13558, 75 Fed. Reg. 69573 (November 15, 2010).
4. 15 C.F.R. § 764.3 (550-552).

**Sarah Pelud is a lawyer in the business immigration practice of BCF LLP, where she serves a diverse array of corporate, institutional and individual clients, advising and consulting on U.S. immigration issues. She is based in Montreal and can be reached at sarah.pelud@bcf.ca.**

# The Option of Investment Arbitration: An Important Part of An Investor's Legal Arsenal

By Andreas Heuser and Christian Leisinger

## I. Introduction

The purpose of this article is to call the attention of readers to investment arbitration as a dispute resolution option for companies or individuals doing business outside of the U.S.A. The system of investment arbitration is well developed and provides dispute resolution options in an independent forum.

Investment arbitration arises as an option in the context of foreign direct investment in (usually) developing states. Unfortunately, the reality of doing business in so-called capital importing countries is a frequent failure by the host state to protect the investment or sometimes even the expropriation by the state of assets once investment is completed. In these situations, many investors might consider that pursuing proceedings in local courts is not worth the cost or effort due to a perception of lack of independence or simply an inefficient judiciary. Investment arbitration offers investors an attractive alternative: a direct right to bring a claim against a host state in an international and neutral forum. Many investors are unaware of this possibility. Indeed, investment arbitration is unique and has only recently been awakened from a long slumber. The numbers of disputes being heard have increased greatly since the mid 90s—especially following financial turmoil such as the Argentine economic crisis which affected numerous U.S. companies. The broad concepts discussed in this article will also be familiar to U.S. counsel from experiences with NAFTA—a treaty framework which also allows independent resolution of investment disputes.

We attempt in the following to bring this unique form of dispute resolution to a new audience and clarify any possible existing misunderstandings relating to legal remedies for wrongful behavior of states normally not known for upholding the rule of law. Firstly, we outline the historical developments in the area of institutional investment arbitration (II.), set out some of the substantive protections offered under investment treaties (III.), show in particular the benefits of bringing a claim under the International Centre for the Settlement of Investment Disputes ("ICSID") in Washington D.C. (IV.), and finally set out some concluding remarks (V.).

## II. Historical Developments

In order to understand the instrument of investment arbitration, one has to firstly consider its historical developments. Over 50 years ago, foreign investors could only seek protection from the local judiciary, via diplomatic channels (so-called diplomatic protection) or from extremely fragmented standards under international investment law, consisting largely of customary law and general principles of law. For foreign investors and their governments, one of the great deficiencies of customary international law was its lack of effective and binding mechanisms for the resolution of private disputes. Foreign investors in the past, aware of the inability to negotiate a satisfactory settlement, would try to secure an arbitration agreement with a host government, or find satisfaction in the local courts. Failing which, a remaining option was to seek espousal of their claim by their home country government—a process that by its very nature was more political than legal.

As a result, the World Bank was over time increasingly required to facilitate the amicable settlement of disagreements that arose between private investors and states. The guiding principle was to promote an atmosphere of mutual confidence through the creation of a neutral institution for the resolution of investment-related disagreements. To reach these goals, the International Centre for Settlement of Investment Disputes (ICSID) had been formally established by the ICSID Convention in 1965 as an affiliate of the World Bank. The ICSID Convention is an international treaty currently signed by 156 and ratified by 144 states. However, the ICSID Convention itself does not contain substantive standards of protection for investments. Instead, it only offers a procedural framework for the resolution of disputes arising out of investments. The framework of the ICSID Convention only comes into play if both parties to an investment dispute have consented to the jurisdiction of ICSID. The consent by a state is regularly incorporated in a bilateral or multilateral treaty.

The historical German connection to investment arbitration is in conjunction with post-war efforts of German companies to obtain investment interests in the developing world. The first bilateral investment treaty ("BIT") of all was concluded between Germany and Pakistan in 1959 and was followed by another 2,700 BITs that exist nowadays between states around the world. The U.S. has entered into a total of 47 BITs with a range of emerging market states—most recently (February 2008) with Rwanda. Examples for multilateral agreements between states are NAFTA or the Energy Charter Treaty that also provide for a dispute resolution mechanism under the auspices of ICSID.

The impetus for the BIT-making activity over the last five decades has been the strong drive by a growing numbers of companies and individuals in industrialized states to undertake direct investments in foreign countries and the consequent need to create a stable international legal framework to facilitate and protect those investments. To gain such certainty and to counter the threat of unfair or irregular national law and regulation, the U.S. and other "capital exporting" states undertook to conclude a series of BITs that would provide clear rules and effective enforcement mechanisms—at least with regard to their treaty partners. Through the instrument of a BIT, an investor does not have to fully rely on the law of the host state that the host government might easily alter. Besides the protection of investments made by nationals and companies in foreign countries another important goal of BITs is the promotion of foreign investments in order to increase the amount of capital and associated technology.

## III. Substantive Protections

From a technical legal perspective, BITs constitute an offer by a host state to investors that they can bring any dispute arising in connection with the investment to independent arbitration. The investor accepts this offer to arbitrate by meeting the prerequisites for a "qualifying investment" in terms of the BIT and may then bring a claim against the state. Thus—unlike the typical form of consent in international commercial arbitration by way of an arbitration clause in a contract—investment arbitration can occur where there is no pre-existing contractual relationship between the investor and the state.

Most BITs define the concept of investment broadly so as to include all sorts of investment forms: tangible and intangible assets, property, and other rights. Generally infrastructure projects and other such "classical" investments will qualify. However, indirect financial interests in shares in a company incorporated in the host state, while challenging the common understanding, have also qualified as investments. In one case, an award in an ICC commercial arbitration proceeding in favor of the investor against a state-owned company which was frustrated in the host state was also held to be part of an investment.

Although the primary function of any bilateral investment treaty is to protect foreign investments, they also often define certain general standards of treatment and also state specific standards for particular matters, such as monetary transfers, the employment of foreign personnel, and the resolution of disputes with the host government. By regulating these kinds of practical aspects of investing overseas, the BIT provides the investor with some level of legal certainty in this respect.

BITs grant aggrieved investors the right to prosecute their claims autonomously, without regard to the concerns and interests of their home countries. As a result, foreign investors are bringing increasing numbers of claims in arbitration when they feel that host countries have denied them the promised protection under a BIT. During the 50-year historical development the legal architecture for the protection of foreign investment has changed considerably and foreign investors are now protected by international treaties, rather than by customary international law alone. A foreign investor may today look to a comprehensive, specific, and largely uncontested set of international legal rules and have recourse to international tribunals to enforce them.

## IV. The Particularities of ICSID Arbitration

Investment arbitration under the ICSID Convention of 1965 deserves particular attention because of its significance, both politically and quantitatively (due to the sheer numbers of ICSID proceedings—over 65% of all investment arbitrations). As already mentioned, ICSID was established under the 1965 ICSID Convention as an arm of the World Bank. As a consequence, it retains a reputation as an independent non-political dispute resolution center. It provides a platform and procedural framework for the resolution of investment disputes; however, it does not provide substantive standards of protection for investments itself. This is left to BITs or multi-lateral investment treaties where state parties have given consent to arbitration.

The ICSID Convention forms a unique framework in international arbitration as it provides for a self-contained administrative body, direct jurisdiction of an ICSID Tribunal over states and direct enforcement of ICSID awards under domestic law. The ICSID system was developed almost exclusively for investor-state disputes. Historic dispute resolution procedures such as diplomatic protection are ruled out.

The established administrative system of ICSID in Washington, D.C. presents a real advantage to both parties to a dispute as the Secretariat provides administrative and procedural support with qualified lawyers guiding the arbitrators and parties through the proceedings. Furthermore, ICSID proceedings generally call on a pool of arbitrators with great experience in both commercial arbitration and international law. The procedure to appoint an arbitrator does not differ greatly from commercial arbitration: generally each party appoints an arbitrator with ICSID appointing the third from its panels of designees (in a small minority of cases a sole arbitrator is appointed).

It is important to note that not every person can obtain the advantages of ICSID proceedings. Moreover, jurisdiction of the arbitral tribunal to hear a dispute under ICSID is usually contentious and heavily argued by both parties. It is very common for arbitral tribunals to bifurcate the proceedings between the jurisdiction and merits phases. The prerequisites of ICSID jurisdiction are set out in Article 25 of the ICSID Convention, specifying that jurisdiction shall extend to any legal dispute arising out of an investment between an investor of a contracting state and a contracting state to which the parties consent in writing to submit to ICSID. Generally the instrument of consent is a BIT. While "investment" was intentionally left undefined in the ICSID Convention, the meaning of the term has been explored by numerous tribunals.

Another key advantage of the ICSID regime is its expeditious system of enforcement. Under Article 53 of the ICSID Convention, an arbitral award is final and binding on the parties and not subject to any appeal or other remedy. Each contracting state is bound to recognize an award as binding under Article 54 and must enforce the award as if it were a final judgment of a court in that state. Thus, investors can enforce an arbitral award not only in the host state, but also in other contracting states where the host state might hold assets. However, some limitations exist on enforceability against assets belonging to the state. Sovereign immunity has been held by some courts (e.g., the U.S. Federal Court for the Southern District of New York in *LETCO v. Liberia*) to prevent enforcement against "sovereign" assets—in that case fees and taxes payable to Liberia. Recent court decisions have made a distinction between assets serving a sovereign purpose (such as embassies or consular property) and those serving a commercial purpose (such as state-owned commercial aircraft).

A further advantage of enforcement under the ICSID regime is the "World Bank factor" whereby due to the close association of ICSID and the World Bank, enforcement of awards in states where the World Bank is active can be made easier due to pressure to comply with an arbitral award.

While one is not able to appeal an award, ICSID arbitral awards are, however, subject to potential annulment. The annulment procedure has been carried out in an increasing number of cases. Article 52 sets out the five exhaustive grounds: improper constitution of the tribunal, tribunal manifestly exceeding its powers, corruption of a member of the tribunal, a serious departure from a fundamental rule of procedure, or a failure of the tribunal to state reasons for its decision. Annulment applications are heard by an *ad hoc* committee of three new arbitrators without the same nationality as the investor or the host state.

## V. Conclusion

Investment arbitration offers unique and direct remedies to companies and individuals active in foreign states. The vast network of BITs contain substantive protections which can be enforced in a neutral forum. The substantive standards in BITs offer investors the inherent protection against expropriation or unfair treatment due to the threat of legal action against the state combined with the opportunity to more easily enforce rights if required in investment arbitration. BITs have been in existence for 50 years since the first German-initiated treaty, although the reliance upon them by investors in arbitration proceedings has only recently gained traction. The World Bank's instigation of ICSID in 1965 provided an impetus for this and now ICSID administers over two-thirds of all investment arbitrations. The system created under the ICSID Convention has particular advantages such as efficiency in administration and generally an experienced complement of arbitrators. Enforcement of claims is especially made more straightforward by the ability for a party to enforce an award as a final judgment in any state signatory to the ICSID Convention.

In summary, although it has a relatively recent history, investment arbitration offers investors very real protection and significantly reduces risk for those investing offshore.

**Andreas Heuser and Christian Leisinger are Associates at Gleiss Lutz (Stuttgart, Germany).**

# The International Arbitration System: How the Pieces Interrelate: International Arbitral Institutions

By Nancy Thevenin

### A. Introduction

Once the parties have decided on arbitration as the preferred dispute resolution mechanism for their international commercial dispute, they must decide whether to have *ad hoc* or institutional arbitration. If a choice is made to have administered arbitration, a third decision must be made as to which institution's rules to select.

### B. The Role of Arbitral Institutions

Institutional arbitration results when the parties in their agreement chose to conduct their arbitration under the auspices and in accordance with the procedural rules of an arbitral institution.[1] The arbitral institutions in no way decide the merits of the dispute; they merely provide an administrative and procedural framework for the proceedings. Having an overseeing body provides added security for, and at the same time protects against abuses by the parties, their counsel or the arbitrators.

In general, the institution's rules address the manner in which the arbitration should be commenced, provides a method for constituting the arbitral tribunal, offers guidelines for certain details of the arbitral proceedings, and determines the costs of the proceedings. While arbitral institutions charge a fee for their services, the professional administration and tested value of their rules are widely seen as enormous advantages in ensuring recognition and enforcement of a resulting award.

Essentially, the role and function of the arbitral institutions are to provide a comprehensive set of rules aimed at respecting the flexibility inherent in the arbitral process while implementing procedures that respect the jurisdictional and procedural requirements for enforceability under the New York Convention.[2]

### C. Typical Institutional Provisions

The three major international arbitral institutions are the International Court of Arbitration of the International Chamber of Commerce ("ICC Court"); the International Centre for Dispute Resolution of the American Arbitration Association ("ICDR") and the London Court of International Arbitration ("LCIA").[3]

First, a short background about the history and structure of these institutions:

### 1. ICC Arbitration

The International Chamber of Commerce ("ICC"), a not-for-profit non-governmental organization, established the ICC Rules of Arbitration in 1922, and in 1923, created the ICC Court. The ICC itself is a major organization that issues policy statements, and provides standards and rules aimed at promoting international trade. Its arbitration rules were designed specifically to handle cross-border commercial disputes. Structurally, ICC arbitration involves the interaction among three main bodies: (a) the ICC Court; (b) the ICC Court Secretariat; and (c) the ICC national committees.

The ICC Court is not a court in the traditional sense, but a body made up of lawyers, legal experts and law professors drawn from approximately eighty-eight different countries and territories. The Secretariat is the permanent staff of the ICC Court, and includes more than fifty people of over twenty nationalities, each fluent in several languages. They are organized in regional teams that follow each case from its inception to the rendering of the award. When the ICC Court is required under its rules to appoint an arbitrator, it calls upon one of the ICC national committees in some ninety countries for assistance in finding the best arbitrator in that region for the case in question.

### 2. LCIA Arbitration

LCIA arbitration involves the interplay amongst the Company, the LCIA Court and the LCIA Secretariat.[4]

The Company is a not-for-profit company limited by guarantee. It consists of the LCIA Board, which is mostly made up of prominent London-based arbitration practitioners. The Board does not participate in the administration of the cases, but merely overseas the operation of the Company.

The LCIA Court is made up of thirty-five leading arbitration practitioners from around the world, no more than six of whom are UK nationals. Its main function is to appoint arbitrators, determine the challenges to the arbitrators, and monitor and control the costs of the process. While the Court meets regularly, most of its functions are performed by its President, one of its Vice Presidents or a Division of the Court. The LCIA Secretariat, in turn, is responsible for the day-to-day administration of the disputes.

### 3. ICDR Arbitration

ICDR is a division of the American Arbitration Association, a not-for-profit public service organization founded in 1926. Its headquarters are in New York City. ICDR was established in 1996 to administer international cases. All cases are handled by case managers headed by team leaders. The case managers manage the administrative aspects of the case, including coordinating the logistics of the arbitration, assisting with arbitrator selection, deciding upon challenges and compensation, as well as assuring the delivery of the award to the parties.

### 4. UNCITRAL Arbitration

In 1976, the United Nations Commission for International Trade Law ("UNCITRAL") developed arbitration rules, which are commonly known as the UNCITRAL Arbitration Rules. UNCITRAL arbitration is unadministered arbitration. Because application of these rules is not administered, it is strongly recommended that parties, in their agreement, select an arbitral institution to act as appointing authority under those rules. As appointing authority, an arbitral institution can assist the parties in the appointment of arbitrators, decide upon challenges to the arbitrators, assist in substituting an arbitrator, as well as handle certain administrative aspects of the case if requested.[5]

Several regional arbitration centers have adopted different versions of the UNCITRAL Arbitration Rules.[6] Before agreeing to arbitration under the rules of any institution, however, it is important to consider the following factors: (1) the experience of the institution with administering international commercial disputes; (2) the breath and scope of the institution's list of arbitrators, especially the range of nationalities of its arbitrators; (3) whether the institution is tied to the local, regional or state government such that the neutrality of the institution or that of its arbitrators may become compromised; (4) the extent to which the institution may impose certain requirements on the arbitral tribunal, and whether those requirements may jeopardize the non-local party's right to a fair proceeding; and, of course, (5) the administrative fees of the institution and its formula for compensating arbitrators.

To avoid making these evaluations for every transaction with parties from different regions around the world, it may be more expedient to become familiar with the rules of the major international arbitral institutions mentioned above.

Arbitral bodies such as the ICC, ICDR and LCIA provide rules that are drafted specifically to resolve business disputes worldwide. All have administered commercial cases involving parties from different cultural backgrounds and legal jurisdictions. Generally, they also employ professionals fluent in several languages such that they are capable of handling cases seated in almost any country around the world.

Generally, their rules grant the arbitrators the right to adjudicate their own jurisdiction;[7] provide that the arbitration agreement is separate from the underlying contract;[8] require the arbitrators to be independent and impartial;[9] and contain default mechanisms to determine the number of arbitrators,[10] the methods for selecting the arbitrators,[11] the place of arbitration,[12] the law to be applied in the proceedings[13] and the language to be used.[14] They also have processes for deciding upon challenges to and replacement of arbitrators.[15] Finally, they contain provisions for waiver of the right to appeal the arbitration award,[16] give tribunals the power to grant provisional and interim relief,[17] and include administrative procedures for collecting the arbitrator's fees and their own administrative fees.[18]

While these are general similarities shared by the major international arbitral institutions, the attached chart describes key differences in their application of these general principles.

### D. Comparisons of Institutions' Rules

See the following chart.

## COMPARISON OF INTERNATIONAL INSTITUTIONAL ARBITRATION RULES

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Website** | http://www.iccwbo.org/court/arbitration/ | http://www.adr.org | http://www.lcia-arbitration.com/arb/uk/htm | http://www.uncitral.org/en-index.htm |
| **Establishment** | 1923 | 1996 | 1892 | 1976 |
| **Headquarters** | Paris | New York | London | n/a |
| **Administration** | International Court of Arbitration ("the ICC Court") | International Centre for Dispute Resolution (international division of the American Arbitration Association) | LCIA (the "LCIA Court") | Not administered |

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Standard 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."<br><br>The published ICC notes add:<br><br>"It may also be desirable for the parties to stipulate in the arbitration clause itself the law governing the contract; the number of arbitrators; the place of arbitration; and the language of the arbitration.<br><br>"Parties should also consider the possible need for special provisions in the event that arbitration is contemplated among more than two parties. In addition, the law in some countries may lay down certain requirements in respect of arbitration clauses." | "Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be determined by arbitration administrated by the International Centre for Dispute Resolution [or the American Arbitration Association] in accordance with its International Arbitration Rules."'<br><br>The parties should consider adding:<br><br>a. "The number of arbitrators shall be (one or three)";<br><br>b. "The place of arbitration shall be (city and / or country)";<br><br>c. "The language(s) of the arbitration shall be _______________." | "Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the LCIA Rules, which Rules are deemed to be incorporated by reference into this clause.<br><br>"The number of arbitrators shall be [one / three].<br><br>"The seat, or legal place, of arbitration shall be [City and / or Country].<br><br>"The language to be used in the arbitral proceedings shall be [ ].<br><br>"The governing law of the contract shall be the substantive law of [ ]." | "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."<br><br>Note—Parties may wish to consider adding:<br><br>(a) "The appointing authority shall be… (name of institution or person)";<br><br>(b) "The number of arbitrators shall be… (one or three)";<br><br>(c) "The place of arbitration shall be… (town or country)";<br><br>(d) "The language(s) to be used in the arbitral proceedings shall be…." |

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Appointment of Tribunal** | Default procedure is for a sole arbitrator to be appointed unless it appears that the dispute warrants three arbitrators (Art. 8(2)).<br><br>Where three arbitrators are selected, each party nominates one arbitrator, and the third arbitrator will be appointed by the ICC Court, unless the parties have provided otherwise (Art. 8(4)).<br><br>All arbitrators must be either confirmed or appointed by the ICC Court. (*See* Art. 9). | Default procedure is for ICDR to appoint a sole arbitrator, or if appropriate, three arbitrators (Art. 5). | Default procedure is for sole arbitrator to be appointed unless the LCIA Court considers that a three-member tribunal is appropriate (Art. 5.4).<br><br>In case of a three-member tribunal, the LCIA Court appoints the chairman (Art. 5.6). | If the parties do not agree on a sole arbitrator, then three shall be appointed (Art. 5).<br><br>If the parties cannot agree on the sole arbitrator, then he / she is appointed by the designated appointing authority (Art. 6(2)).<br><br>If no appointing body is specified, either party may request the Secretary-General of the Permanent Court of Arbitration in the Hague to designate appointing authority (Art. 6(2)).<br><br>If appointment is by appointing authority, the authority submits a list of names to the parties, but has the ultimate decision (Art. 6(3)).<br><br>If parties have agreed on three arbitrators, each appoints one arbitrator who together agree on a third. In default a party's arbitrator or the third arbitrator may be appointed by appointing authority (Art. 7). |
| **Security for costs** | Rules silent, but case law demonstrating that the tribunal through the power to order interim or conservatory measures (Art. 23) can award security, but that this will only be exercised in exceptional cases. | Rules silent. | Tribunal has express power (Art 25.2), and the parties cannot apply to any state court for security for costs available from the tribunal under Art 25.2. *See* Art. 25.3. | Rules silent. |

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Interim Measures** | Yes.<br>The tribunal has the power to order any interim or conservatory measure it deems appropriate (Art. 23). The parties may apply to any competent judicial authority for interim or conservatory measures (Art. 23(2)).<br>**Note**: ICC recently started publishing its Rules for Pre-Arbitral Referee Procedure (in force as of 1990) in the same booklet as its Arbitration Rules. The Pre-Arbitral Referee Rules provide a means of obtaining urgent interim or conservatory measure prior to the filing of the arbitration or before the arbitral tribunal is put in place. | Yes.<br>The tribunal may take whatever interim measures it deems necessary (Art. 21). A request for interim measures to a judicial authority shall not be deemed incompatible with the agreement to arbitrate (Art. 21(3)).<br>Art. 37 provides parties with a mechanism for obtaining emergency relief prior to constitution of the arbitral tribunal. | Yes.<br>Wide powers under Article 25. In addition, Art. 25.3 provides that the powers of the tribunal under Article 25 shall not prejudice any party's right to apply to any state court for interim measures. | Yes.<br>Tribunal has power (Art 26) and parties may also apply to a local judicial authority. |
| **Confidentiality** | As between the parties, the rules are silent.<br>The ICC Court treats all of the cases as confidential. *See* Appendix I, Art. 6 and Appendix II, Art. 1 of the ICC Rules. | As between the parties, the rules are silent.<br>Rules provide that hearings are private unless the parties agree otherwise or the law provides to the contrary (Art. 20(4)).<br>Duty of confidentiality placed on the arbitrators and the administrator (Art. 34). | Yes.<br>General principle for parties to keep confidential all documents produced in the proceedings, except to the extent required by law to pursue or protect against legal claims (Art 30).<br>The tribunal's deliberation are confidential (Art. 30.2) and all meetings and hearings are private (Art. 19.4). | Rules are silent, but hearings must be held *in camera* (Art. 25(4)). |

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Summary/ expedited process** | Yes.<br><br>The parties may agree to shorten the various time limits set out in the rules. Any such agreement entered into subsequent to the constitution of a tribunal shall become effective only upon the approval of the tribunal (Art. 32(1)). | Yes.<br><br>The tribunal exercising its discretion should conduct the proceedings with a view to expediting a resolution of the dispute. It may conduct a preparatory conference with the parties for the purpose of agreeing to procedures to expedite the subsequent proceedings (Art. 16(2)). | Yes.<br><br>Tribunal may at any time extend or abridge a period of time prescribed under the Rules or the arbitration agreement (Art 4.7).<br><br>In exceptional urgency on or after the commencement of the arbitration any party may apply to the LCIA Court for the expedited formation of the tribunal including the appointment of any replacement arbitrator (Art 9).<br><br>The LCIA Court may in its complete discretion abridge or curtail any time limit under the Rules for the formation of the tribunal including service of the Response and of any matters or documents missing from the request, but it is not entitled to do this with any other time limit (Art. 9.2). | Rules silent. |

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Disclosure/ discovery** | Vague.<br><br>Rules leave it up to the parties and the tribunal to decide upon the details of discovery and disclosure.<br><br>Art. 15 provides that where the ICC Rules are silent (which they are as to discovery and disclosure) the proceedings are governed by any rules which the parties or, failing that, the tribunal agree upon.<br><br>Art. 20 provides that the tribunal may summon any party to provide additional evidence. | Specific.<br><br>The tribunal may order a party to deliver to the tribunal and to the other party a summary of the documents and other evidence which that party intends to present in support of its claim or defense and the tribunal may order parties to produce other documents, exhibits or evidence it deems necessary or appropriate (Art 19). | Specific.<br><br>The tribunal has the power to order any party to produce documents in the party's possession, custody or power which the tribunal determines to be relevant (Art 22.1(e)).<br><br>Tribunal also has the power to order any party to make any item under its control relating to the arbitration available for inspection (Art. 22.1(d)). | Specific.<br><br>The tribunal may require the parties to deliver documents and any other evidence which that party intends to present in support of its claim or defense (Art 24). |
| **Waiver of Appeal** | Yes.<br><br>(Art. 28(6)). | Yes.<br><br>(Art. 27(1)). | Yes.<br><br>(Art. 26.9). | No. |

| | ICC | ICDR | LCIA | UNCITRAL |
|---|---|---|---|---|
| **Costs** | Fees paid to the institution and to the arbitrators are based on the amount in dispute (Art. 30).<br><br>ICC Cost calculator:<br><br>http://www.iccwbo.org/court/arbitration/id4097/index.html.<br><br>For a US$10m dispute the administrative fees would be US$51,400 and the fees of 3 arbitrators would be around US$318,705 (totaling US$370,105). | Administration fee based on amount of claim (*see* Administrative Fee section in rules), and arbitrator's fees based on daily or hourly rate to be negotiated by ICDR, parties and arbitrator (Art. 32). | Hourly rates are applied by the LCIA Court and its arbitrators, with part of the LCIA's charges calculated by reference to the tribunal's fees.<br><br>£1500 registration fee; time spent on administration £100–£200 per hour plus expenses; arbitrators fees to be negotiated directly with the arbitrators but should be in the range of £150 to £350 per hour unless the parties specifically agree otherwise. | Fixed by tribunal and should be reasonable in amount as well as having regard to schedule of fees of appointing authority, if applicable (Art. 39). |
| **Certain Unique Features** | **Appointments**:<br><br>No list of arbitrators. ICC reaches out to its national committees for nominations of arbitrators. (*See* Arts. 9(3), (4) and (6)).<br><br>**Terms of Reference:**<br><br>Within two months of receiving the file, the arbitrators and the parties are required to draft a document summarizing the parties' claims, specifying the relief sought and listing the issues to be determined (Art. 18).<br><br>**Scrutiny:**<br><br>All awards, interim, partial and final are scrutinized by the ICC Court (Art. 27). | **Pre-arbitral emergency relief:**<br><br>Provision for emergency relief before tribunal is constituted mentioned above (Art. 37). | **Place of arbitration:**<br><br>London is the default place of arbitration, unless the parties argue otherwise (Art. 16.1).<br><br>**Multiple parties:**<br><br>LCIA Court will appoint the tribunal without regard to the nomination made by the parties (Art. 8).<br><br>**Joinder of parties:**<br><br>Tribunal may allow party to be joined and no requirement for consent of all the parties to the joinder (Art. 22.1(h)). | **Repetition of Hearings:**<br><br>If sole or presiding arbitrator is replaced, any hearing held previously must be repeated (Art. 14). |

## E. Conclusion

To conclude, selecting the appropriate arbitral rules is an important decision that will affect the efficiency and cost of a dispute. While the arbitral institutions have the same main purpose and function, they differ in important ways in their level of administration, the rights afforded to tribunals operating under their rules, and in certain procedures available to the parties. These factors, along with the nature of any potential dispute, must be considered when settling on the appropriate rules for your case.

## Endnotes

1. *See* Robert H. Smit, *International Commercial Arbitration: Drafting the Arbitration Clause and Selecting the Arbitration Rules to Govern the Arbitration* (April 1, 2003).
2. *See* Article V(1)(b)(c) and (d) of the 1958 United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), which provide in pertinent part that recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, if that party can prove that it was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration; or that 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 country where the arbitration took place.
3. Other international arbitral institutions are the World Intellectual Property Organization ("WIPO"), which is based in Geneva, Switzerland, and handles intellectual property disputes; the Stockholm Chamber of Commerce ("SCC"), based in Stockholm, Sweden, and used mostly by parties from Eastern Europe; the International Centre for Settlement of Investment Disputes ("ICSID") in Washington, D.C., an institution established under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States ("Washington Convention"), which handles disputes between member states and nationals of other member states; and the Permanent Court of Arbitration ("PCA") at The Hague, which handles disputes between States, or between States and private parties or between intergovernmental organizations.
4. *See, e.g.*, "About the LCIA" at http://www.lcia-arbitration.com/.
5. *See, e.g.*, Rules of ICC as Appointing Authority (http://www.iccwbo.org/court/arbitration/id4598/index.html) or ICDR Procedures for Cases Under UNCITRAL Arbitration Rules (http://www.adr.org/sp.asp?id=22091).
6. *See, e.g.*, the British Columbia International Commercial Arbitration Centre ("BCICAC"), China International Economic and Trade Arbitration Commission ("CIETAC"), the German Institution of Arbitration ("DIS"), the Hong Kong International Arbitration Centre ("HKIAC"), the Japan Commercial Arbitration Association ("JCAA"), the Kuala Lumpur Regional Centre for Arbitration ("KLRCA"), the Singapore International Arbitration Centre ("SIAC"), and the Centro de Arbitraje de México ("CAM").
7. Tribunal's right to adjudicate its own jurisdiction: ICC 6(2); ICDR 15(1); LCIA 23.1.
8. Arbitration agreement separate from underlying contract: ICC 6(4); ICDR 15(2); LCIA 23.1.
9. Independence and impartiality of arbitrators: ICC 7; ICDR 7; LCIA 5.2.
10. Default mechanisms for number of arbitrators: ICC 8(2); ICDR 5; LCIA 5.4.
11. Methods of selecting arbitrators: ICC 8(3)-(4) and 9; ICDR 6; LCIA 7 and 8.
12. Place of arbitration: ICC 14; ICDR 13; LCIA 16.
13. Applicable law: ICC 17; ICDR 28(1); LCIA 22.3.
14. Language: ICC 16; ICDR 14; LCIA 17.
15. Challenges and replacement of arbitrators: ICC 11 and 12; ICDR 8-11; LCIA 10 and 11.
16. Waiver of the right to appeal: ICC 28(6); LCIA 26.9; ICDR 27(1) providing that awards are "final and binding."
17. Provisional & interim relief: ICC 23; ICDR 21; LCIA 25.
18. Fees and Costs: ICC 30 and 31 and Appendix III (Arbitration Costs & Fees) ; ICDR 31-33 and Annex about administrative fees; LCIA 24, 28 and Annex "Schedule of Arbitration Fees Costs."

**Nancy M. Thevenin is Special Counsel and global coordinator for Baker & McKenzie's International Arbitration Practice Group. Ms. Thevenin advises on arbitration institutions, *ad hoc* cases, use of pre-arbitral referee procedures, dispute boards and expertise proceedings. Her experience includes handling arbitrations under the auspices of the International Chamber of Commerce and the International Centre for Dispute Resolution of the American Arbitration Association, mediations and advising on early resolution of matters which would otherwise become formal disputes. She specializes in international commercial litigation, international arbitration, creditors' rights and business torts. She can be reached at Nancy.M.Thevenin@bakernet.com.**

# International Transactions: An aide memoire to get your dispute resolution clause right!

By Claire Morel de Westgaver

## 1. Introduction

Dispute resolution clauses are commonly referred to as “midnight clauses.” No matter what the type or value of the transaction is, dispute resolution issues are usually brought to the table late in the day. Unfortunately, at that point in time, it is already too late. Satisfied with their success on agreeing the (allegedly) most important clauses, counsels are hopeful that their task is almost complete. In addition, they are conscious that raising the eventuality of potential disputes may lead to further tension between parties resulting in the whole agreement falling apart, which of course they want to avoid.

In international transactions, the risk of being dragged to an unfriendly or inefficient court or other unknown forum is greater. As a result, should a dispute arise, the dispute resolution clause in an agreement may well become the most central clause of all. In order to avoid that a dispute resolution generates more problems than it solves, both in terms of the dispute resolution process’ level of efficiency and costs incurred by the parties, it seems therefore worth giving it the care and attention it deserves from the outset.

This article aims at outlining the factors to take into account and the main options available while considering the best dispute resolution clause for your contract. What follows is *not* an exhaustive list of processes, but rather a practical guide in which the author identifies the pitfalls and ways to avoid them, as well as issues in relation to which the position in the relevant (foreign) jurisdiction(s) might have to be checked to avoid surprise.

## 2. Factors to Take Into Account When Deciding Which Dispute Resolution Mechanism to Choose

### 2.1 Your counterpart

The jurisdiction in which your counterparts are incorporated and / or are trading may have an impact on both the application of mandatory law and the choice of dispute resolution process. Further, parties should pay attention to the number and nature of their counterpart(s), as it may equally inform on the adequate dispute resolution mechanism.

In terms of number, if they are entering into a multi-party contract, parties should bear in mind that the dispute resolution clause—more particularly so with regard to arbitration—may need to reflect the multiplicity of parties, for instance as to the method to appoint the tribunal or joinder of any party signatory to the clause but not party to the proceedings. With regard to the nature of the parties, some processes may be particularly efficient for individuals as opposed to corporations. Similarly, public-owned companies or governments may require that any disputes be submitted to arbitration to the exclusion of any national court (for neutrality reasons), while the same may not be appropriate if the agreement you are drafting is meant to stand as terms and conditions to be approved by customers.[1]

### 2.2 International aspects of the transaction

Issues to consider include the place of performance, the location of the subject matter (e.g., project to be constructed) and the assets. Similarly, note that international elements may arise from related contracts, e.g., financing of the project by foreign investors.

### 2.3 Likely range of value at stake

Although it sounds basic, it appears that parties often forget this aspect of any potential dispute. By way of example, it is not rare to see arbitration clauses providing for a 3-member tribunal in relatively small value agreements. A careful value versus costs analysis should be undertaken for each type of dispute.

### 2.4 Time frame/speed

Some industries such as IT or construction require, more than others, fast resolution so that the project can continue while the dispute is solved.

### 2.5 Type of relief likely to be required

If possible, parties should attempt to foresee the types of relief they might be seeking and check that the relevant remedy would be available in a given jurisdiction, through a certain process. Would these be injunctions, specific performance or damages?

### 2.6 Confidentiality

The need for confidentiality is an important factor. Publicity of any aspects of a dispute may damage the parties’ reputation or the purpose for which they entered into the transaction, e.g., the transfer of trade secrets.

### 2.7 Third-party neutral

Some disputes require that the judge or third-party neutral who will impose or assist the parties with finding a solution be expert in the relevant legal area (e.g., patents) or has knowledge of the industry.

### 2.8 Enforcement issues

While arbitral awards are directly enforceable in the 145 states signatory to the New York Convention 1958, foreign judgments will require the assistance of specific treaties, as well as heavier procedural steps to go through to ensure recognition and enforcement. Expert determination decisions as well as mediated settlements are usually enforceable as contracts. As a result, the benefits available thereof are subject to the usual defences and review by the relevant courts.

### 2.9 Arbitrability issues

Although the remit of arbitrable issues has expanded[2] in the last decade to the extent that virtually most of civil / commercial matters may be submitted to arbitration, parties may wish to consider this to avoid surprise.

### 2.10 Need or not to establish a precedent

If possible, counsel may consider whether there will be any need to establish a precedent, for example in relation to a recurrent issue. To illustrate this, insurance disputes have customarily been resolved through arbitration to avoid that a finding on a construction issue of the policy be used in further disputes involving the same policy terms but a different insured.

### 2.11 Ability to appeal

The availability of recourse against the outcome may prove to be central in practice. The flipside to any appeal / review is the additional time and costs which will incur before a final decision is rendered.

## 3. Types of Dispute Resolution Clauses

### 3.1 Governing law clauses

Before addressing the process of any dispute resolution mechanism, parties usually agree on the law which will govern their agreement. Logically, the law should be chosen prior to the agreement itself being drafted.

Given the international nature of the transaction, parties may opt for a set of laws of one jurisdiction or international / equitable[3] principles (e.g., *Lex Mercatoria*). In terms of the national laws, this may either be the law of any parties' jurisdiction or a law of a third party / neutral country.

If the contract fails to provide for a choice of law clause, the relevant conflict of laws rules will apply. In this case, the parties will encounter a level of uncertainty as to the applicable law, which may lead to disputes and costs being incurred.

In terms of clause drafting as such, it is usually recommended to separate the governing law clause from the dispute resolution clause, as issues governed by the substantive law may of course arise independently from any proceedings.

### 3.2 Jurisdiction clauses

If court is preferred, selection of the right forum is of paramount importance. Careful consideration should therefore be given to the following aspects of potential national courts: average time frame, costs, standard of justice and compliance with due process and availability of relevant legal advice.

Further, should the jurisdiction clause give exclusive or non-exclusive jurisdiction to the courts it points to? A non-exclusive jurisdiction clause will allow flexibility to the parties as any of them will be able to bring proceedings in a jurisdiction other than the one pointed to by the clause. On the other hand, an exclusive jurisdiction clause would allow less flexibility but more certainty as to the forum. The latter may be preferred if your client wants to avoid ending up in litigation in an unfriendly jurisdiction.

As rules for service process may significantly differ from one jurisdiction to another, providing for methods of services and / or an agent for service process in the agreement might prove useful.

### 3.3 Arbitration clauses

Arbitration remains the preferred means to resolve international disputes, hence the below detailed section on elements (both basic and optional) constituting effective arbitration clauses.

#### Basic elements

Basic elements of an arbitration clause are the seat, whether it will be ad hoc or institutional arbitration, if institutional the arbitration institution / rules,[4] number of arbitrators and language. The choice of the seat should be based on both legal and practical considerations. The law of the seat will apply to the procedure of the arbitration.

As a matter of practice, to ensure efficiency, parties should refrain from providing for institutional rules to apply to arbitrations administered by another institution or to *ad hoc* proceedings, for which UNCITRAL Arbitration Rules[5] or Arbitration Rules of the Chartered Institute of Arbitrators are generally appropriate.

Parties should attempt to agree on the number of arbitrators. If they fail to do so the default rule under most leading arbitration rules is one. A panel of three is obviously more costly but may bring higher levels of neutrality. In addition, parties should also agree on the method of selection and replacement of the arbitrators and select an appointing authority for *ad hoc* arbitrations.

#### Optional elements

In addition to the basic elements listed above, it may be appropriate to reach an agreement on additional issues, provided that such agreement does not backfire, for instance if the dispute which in fact arises is not of the nature anticipated at the time the contract was drafted.

For instance, contrary to the misconception that arbitration is always private and confidential, the level of confidentiality depends on the parties' agreement and the applicable law. As such parties may wish to add a clause to this effect. Parties may also wish to specify the qualifications required for the arbitrators or information as to the scope and nature of discovery, costs allocation, time limits or the award itself. Subject to validity under the applicable law, in certain limited circumstances (often linked to the need for confidentiality), parties may benefit from an unreasoned award. Parties are, however, advised to consider all the consequences to such a clause, for example in relation to challenge. Similarly, it is common for parties to waive their right to judicial review of the award on the merits. Such waiver is anyway provided in some of the leading arbitration rules.[6] As a result, if parties wish to maintain their right to judicial review (to the extent available under applicable law), they should check before agreeing upon certain rules.

Further, depending on the applicable law, parties may need to preserve some of their rights; for instance, their right to apply to court to seek interim relief / assistance in support of arbitration or their right to bring action in court for the enforcement / challenge of an award.

#### "For the benefit" or "sole option" clauses

As their names indicate, "for the benefit" or "sole option" clauses provide for one party to be granted the right to choose between arbitration and litigation. Effectively, these clauses give the ability to one party (only) to select the most appropriate form of dispute resolution process after the dispute has arisen. Whilst considered as valid in many leading arbitration jurisdictions,[7] these clauses might not be enforceable where a party will need it to be down the line, and counsel should check this point under applicable law before entering into this type of dispute resolution agreement.

#### Optional clauses

Parties may also intend to provide for the option to arbitrate rather than an obligation to arbitrate in their dispute resolution. How such clause will be interpreted will also depend on the applicable law.[8] In any event, leaving the option open may lead to protracted disputes and create uncertainties as to what the appropriate forum will be.

#### Split dispute resolution clauses

Disputes as to what falls within the scope of the dispute resolution clause tend, or are more likely, to arise with what is sometimes called "split" dispute resolution clauses. Under such clause one type of disputes is to be submitted to a process other than the one provided for all other disputes. Although such a scheme may prove to be appropriate in agreement when one type of dispute, e.g., relating to the valuation of shares or IP rights, requires a different resolution process, the identification of the type of dispute may itself give rise to a dispute. In addition, by agreeing upon such a clause, parties take the risk that claims relating to the same agreement are resolved in two different fora, which may not be efficient both in terms of costs and practicality.

### 3.4 ADR and escalation clauses

With the global rising popularity of ADR, courts around the world tend to embrace a more and more supportive approach to it. The most used and probably most effective forms of ADR for international disputes are negotiation, mediation and arbitration. Expert determination, neutral evaluation, summary jury trial remain rare. As for the so-called Mediation / Arbitration, before agreeing to such a process, parties should ensure that an arbitral award rendered by an individual who subsequently fulfilled the role of mediator and arbitrator would be enforceable in the jurisdiction(s) where assets are located. Such an award may indeed give rise to impartiality issues to the extent that, as mediator, the third-party neutral has had *ex parte* communication with the parties, which may not be acceptable under due process standards in certain jurisdictions.

If the ADR mechanism is not binding, the reference to it in a dispute resolution clause usually should be followed by a binding process (arbitration, litigation or expert determination) in case the non-binding process fails. Failure to provide for a binding process would lead the parties to having the uncertainty of not knowing which court will ultimately have to resolve their dispute.

## 4. Drafting Tips

### 4.1 Make sure the clause will work in practice

If they wish to use rules, parties are advised to use the relevant model clause as starting point. This will ensure a higher level of certainty and enforceability as the model clauses have been tested before.

In relation to multi-tier dispute resolution or escalation clauses, which are very common in agreements involving parties from different jurisdictions, drafting lawyers should make the appropriate enquiries to ensure that the functions and processes are appropriate to the dispute likely to arise (e.g., "executives designated by each Party to confer and attempt to resolve the dispute in good faith"). Similarly, in order to avoid "circle clauses," parties should make sure that each period(s) leading to the next step be triggered by a defined and undisputable event (e.g., "If the Parties fail to resolve the dispute within 30 days of the notice of dispute being served to all other Parties, any Party may commence arbitral proceedings pursuant to…").

### 4.2 Scope of the clause

Unless special circumstances dictate otherwise, it is usually recommended to use a wording broad enough to encompass any claims likely to arise (e.g., "any dispute arising out of this agreement or relating thereto….." Subject to the relevant court's interpretation, this will enhance certainty and ensure that any claims relating to the same transaction (whether contractual or tortious) will fall within the scope of the dispute resolution clause and be resolved in one single forum.

On a different note, in escalation clauses, parties are generally encouraged to define the scope of disputes to be referred to each process in identical terms at every stage.

### 4.3 Avoid conflicts

If the transaction relates to one main project from which may flow more than one contract, it is central to ensure that related claims are resolved in one single forum. If appropriate, parties may therefore be advised to ensure that the dispute resolution clauses contained in all the related agreements are alike or at least compatible. Another way to avoid conflicting dispute resolution clauses in multi-contract projects is to have parties agree an umbrella dispute resolution clause which would be applicable to any disputes arising out of any of the agreements covered by the umbrella clause.

Another type of conflict that occurs more than one would think relates to an agreement which includes both an arbitration clause and an exclusive jurisdiction clause. Parties are encouraged to watch out for this as such conflict may cause uncertainty depending on the applicable law. It should, however, be noted that the position in New York and England and other arbitration friendly jurisdictions is that these clauses can be reconciled by reading the jurisdiction clause as a submission only to the court's supervisory jurisdiction over the arbitration.[9]

With regard to arbitration, to the extent that parties can contract out of the rule in question, conflicts between arbitration rules referred to in a clause and the clause itself are generally resolved by the clause taking precedence over the arbitration rules. In practice, counsel should therefore carefully review rules before agreeing upon them; and if they do, they should refrain from addressing in the clause issues which are already dealt with in the rules.

## 5. Conclusion

According to the relevant factors identified earlier, in order to ensure that a clause is effective both in terms of its interpretation and implementation, parties should find the right balance between relatively straighforward model dispute resolution clauses which may or may not address their specific and more complex requirements, and over engineered clauses which may give rise to peripheral issues and protracted disputes about procedure.

## Endnotes

1. Due to the application of consumer regulations, arbitration may not be allowed in the relevant jurisdiction(s) you are intending to arbitrate. In the United States, while the general position is that arbitration agreements in consumer contracts are valid (see, e.g., *Borowiec v. Gateway 2000, Inc.*, 808 NE2d 957 (I11.2004)), some courts have held them to be unconscionable (See, e.g., *Brower v. Gateway 2000, Inc.*, 1998 WL 481066 (NYAD 1 Dept–Aug 13, 1998). In relation to England and Wales, see the Unfair Terms in Consumer Contracts Regulations 1999, which apply to arbitration (see sections 89-91 of the Arbitration Act 1996).
2. R. Doak Bishop, *A Practical Guide for Drafting International Arbitration Clauses*, 1 International Energy Law & Taxation Review 16 (2000).
3. Most of the leading arbitration regimes and rules allow for parties to give the parties the ability to empower the Tribunal to determine the dispute as amiable compositeur or *ex aequo et bono*, i.e., in equity rather than under strict application of the law (e.g., Article 35.2 of the ICC Rules; Article 28.3 of the ICDR Rules; Article 22.4 of the LCIA Rules).
4. Options include the International Chamber of Commerce (ICC) Rules of Arbitration, the International Arbitration Rules of the International Centre for Dispute Resolution (ICDR / AAA); the London Court of International Arbitration (LCIA) Rules, the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) and the Swiss Rules of International Arbitration (Swiss Rules).
5. These are the arbitration rules of the United Nations Commission on International Trade Law.
6. E.g., Article 26.9 of the LCIA Rules; Article 26.6 of the ICC Rules; Article 64(a) of the WIPO Arbitration Rules.
7. See, e.g. *Oblix, Inc. v. Winiecki*, 374 F.3d 488, 490-491 (7th Cir. 2004); *Sablosky v. Edward S. Gordon Co., Inc.*, 535 N.E. 2d 643 (NY 1989). For English law, see *NB Three Shipping Ltd v Harebell Shipping Ltd* [2005] 1 All ER; *Law Debenture Trust Corp plc v Elektrim Finance BV* [2005] 2 All ER 476. For Europe generally, see Article 17 of the Brussels Regulation (Council Regulation (EC) No 44 / 2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 12, 16.1.2001, art 17).
8. U.S. courts are generally of the opinion that optional clauses constitute compulsory arbitration (see, e.g., *Austin v. Owens-Brockway Glass Container, Inc.*, 78 F. 3d 875, 879 (4th Cir. 1996); however, some have also held that if the language of the clause is clearly optional it may not therefore be subject to compulsory arbitration (see, e.g., *Eurosteel Corp. v. M/V Millenium Falcon*, 2002 U.S. Dist. LEXIS 15905 (N.D. Ill. 2002)). In Singapore, the High Court ruled that a clause that confers a unilateral right on either party to refer a dispute to arbitration is capable of constituting an arbitration agreement, within the meaning of the International Arbitration Act (Michael Hwang, 13 May 2002–Singapore High Court, *A contribution by the ITA Board of Reporters)*. Conversely, under English law, such a clause does not amount to an arbitration agreement and parties would therefore not be entitled to a stay of the court proceedings (*Halifax Financial Services Ltd v Intuitive Systems Ltd* [1999] 1 All E.R.).
9. *Montauk Oil Transportation Corp v. S.S. Mutual Underwriting*, No. 90 Civ 3801 (JFK) (New York); *Paul Smith Ltd v H&S International Holding Inc* [1991] 2 Lloyd's Rep. 127 (England); *Tri-MG Intra Asia Airlines v Norse Air Charter Ltd* [2009] SGHC 13 (Singapore).

**Claire Morel de Westgaver is an associate in the Dispute Resolution Group of Bird & Bird. She is based in the London office and can be reached at claire. moreldewestgaver@twobirds.com.**

# How to Deal with Pre-Trial Discovery in Continental Europe

By Dr. Denis Gebhardt and Stefan Buettner

The considerable differences between the Codes of Civil Procedure in the U.S., on the one side, and in Continental Europe on the other side, are (from a transnational business perspective) often viewed as an obstacle. However, whenever pre-trial discovery in proceedings before state or federal courts has to be conducted in a state of Continental Europe, such differences bear chances for parties who want to avoid or to limit as well as for parties requesting discovery measures. This article addresses possible options concerning document discovery and depositions taking the rules in Germany as an example.

Avoiding document discovery in Germany is fairly easy to accomplish because it is prohibited under German law. Germany has objected to Art. 23 of the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters of March 18, 1970 ("Hague Convention") so that the order that documents which are available on German soil shall be produced cannot be enforced in Germany. The downside is, of course, that the competent U.S. court will in most cases regard the refusal of a party to produce documents based on the rules in Germany as contempt of court with the respective consequences. In this respect, it is sometimes argued that apart from the objection of Germany to Art. 23 of the Hague Convention, local data protection rules prohibit the disclosure of the requested documents. In practice, however, such argument is (at least currently) rarely accepted by U.S. courts. Thus, while the option to avoid document discovery in Germany is available, it should be a means of last resort and in practice many parties do not exercise this option in order avoid the contempt of court consequences.

The situation is more complex when it comes to depositions. Even though the German Code of Civil Procedure does not provide for depositions at all, it is not possible to completely prevent depositions in Germany. The options available are based on the fact that parties to proceedings pending before a court in the U.S. are not permitted to conduct depositions on the German territory without knowledge and involvement of the German authorities designated under the Hague Convention. Each of the 16 German states appointed one authority to be competent to accept requests for legal aid from foreign authorities (in the state of North Rhine-Westphalia this would be, for example, the Court of Appeals Düsseldorf).

As a consequence, at least one of the parties must ask the U.S. court to file a request to render legal aid with the German authorities. Such request has to state the name of the witness to be deposed and the way in which the deposition shall take place. In this respect, the U.S. courts predominantly rely on the parties to draft a respective document and review it only after the parties have submitted a joint draft or—if they cannot agree on the wording—two separate drafts. It is still unknown to many parties and courts in the U.S. that under German law the deposition must take place before a German judge who primarily poses the questions to the witness. Counsel may only ask additional questions subsequent to the judge, and such questions must have a relation to the responses made by the witness. The request must contain a list of questions which the German judge shall ask the witness. Accordingly, the request to be filed by the U.S. court must take these circumstances into account and if it does not, the German authorities can simply reject the request. Since they are often confronted with non-compliant requests from U.S. courts, some German judges contact the U.S. court subsequent to the receipt of the request and set out what, in their view, should be corrected within the request. There is, however, no guarantee that the German court will grant such a remedy, so that the focus should be to file a compliant request from the outset.

A party opposing the deposition has several options to at least delay the proceedings. Should the U.S. court and the other party not be aware of the German rules the opposing party may simply lean back and await the rejection of the request by the German authorities which is, of course, a quite obstructive approach. Alternatively, the opposing party may consider getting actively involved in the drafting of the request, attempting to influence the list of questions posed to the witness.

The party requesting the deposition should, on the other hand, assist the U.S. court in preparing the request for legal aid so that this request will be accepted by the German authorities. Thus, the requesting party should explain to the U.S. court the differences between the two systems and the need to address the above described issues in the request. This includes the chance to actively influence the question list to be asked by the German judge. It might, in addition, be helpful to involve local counsel already at this stage in order to comply with all relevant local rules and customs.

Once the request for legal aid has been accepted by the German authorities, it is still required to invest considerable efforts in order to assure that the deposition will have a usable outcome. At this stage, it is no longer necessary to assist the U.S. court. Instead, the parties must assist the German court to actually depose the witness. The need for assistance is due to the fact that the outcome of the depositions would not be helpful if the German judge strictly applied the German rules for the questioning of a witness.

In application of such rules, the German judge would not permit a verbatim transcript and would instead summarize and dictate the responses in a protocol in the German language. There are also no court reporters available who could administer the oath. The German rules of civil procedure rather provide for the oath to be administered by the judge who examines the witness, but only if one of the parties requests that the witness swears the oath. These substantial differences to the U.S. system do not mean that a German court would not allow that court reporters flown in from the U.S. as well as interpreters attend the hearing. German judges often also accept that the witness will be sworn in at the beginning of the deposition. However, the German court will not make these concessions voluntarily. Lengthy discussions with the German judge are sometimes required until the rules for the depositions are agreed, in particular, if one of the parties strongly objects to the deviation from the strict appliance of the German rules.

The actual deposition will take place at a date and time to be determined by the German court. As described above, the main role of the German judge is to examine the witness based on the question list which is part of the request filed by the U.S. courts. The main focus of the party opposing the deposition at this stage is to monitor that the judge will not deviate from the question list, while the party requesting the deposition should ensure that the witness within the corset of the question list provides comprehensive testimony. The chance to ask questions in addition to the questions asked by the judge is available and should be exercised when required.

Once the deposition in Germany is completed, the post-examination period involves the battle of the parties before the U.S. court over the admissibility of all evidence taken in Germany. The issue which is often debated is whether or not certain questions asked were admissible. Furthermore, it is often argued by parties that given the substantial differences between the proceedings in the U.S. and in Germany, the evidence is completely inadmissible. In particular, it is alleged that the parties did not have the opportunity for a U.S.-style cross-examination since the German judge primarily asked the witness the questions, and the parties only had the opportunity to ask additional questions once the judge had completed the deposition. However, taking into account that the U.S. has ratified the Hague Convention, such arguments can have no merits. By becoming a party to the Hague Convention, a state accepts, and is aware, that rules of civil procedure may vary from jurisdiction to jurisdiction. Consequently, such differences cannot serve as a valid argument against the admissibility of evidence taken under the Hague Convention.

The example of Germany demonstrates that there are options for both sides to the litigation to take advantage of the fundamental differences of the systems of civil procedure. In the event that the document discovery or the deposition shall take place in another state of Continental Europe it is thus worthwhile to review whether or not the options described above are also available, in particular, since the rules applicable in such other states are quite similar to the German rules, which is demonstrated by the following examples: In France it is required to strictly adhere to the provisions of the Hague Convention and it even involves the risk of criminal prosecution in France if pre-trial discovery measures are conducted in deviation from such rules. Spain has also filed an objection to Art. 23 of the Hague Convention so that document discovery is not available in Spain. The rules of civil procedure in Austria are similar to the German rules.

It can be concluded that the clash of the systems is only an obstacle if a party refuses to get actively involved and to take advantage of the options that come with this clash. The fact that documents or witnesses are only available on the other side of the Atlantic Ocean should not prevent a party from requesting pre-trial discovery measures. With diligent preparation the results are both usable and helpful within the proceedings pending before a U.S. court. As a general rule, it seems most advisable for the party opposing the pre-trial discovery measures to become actively involved in that process very early.

**Dr. Denis Gebhardt, LL.M. is a partner with Beiten Burkhardt Rechtsanwaltgesellschaft mbH in Düsseldorf, Germany. Stefan Buettner is Legal Counsel at OTIS GmbH & Co OHG in Berlin, Germany.**

# Offshore Financing: A Guide for In-House Counsel

By Sidney S. Goldstein

This article will briefly provide a guide for internal counsel as to how to prepare for the financing of her company (the Borrower) which is secured by collateral located overseas and / or guaranteed by a Subsidiary domiciled overseas, which may own all or part of such collateral.[1]

Obviously you cannot provide a legal opinion as to the enforceability of the guaranty or the perfection of the lender's security interest or lien in the offshore collateral. However, you should be in a position to provide guidance to the Borrower as to what information must be gathered and anticipate the legal documentation to be requested by lender's counsel. In short, do not allow the Borrower to be taken by surprise either by the complexity of the transaction and / or the cost of consummating same.

This scenario was all too common during the recent financial crisis. Both borrowers and lenders in order to maintain the viability of a credit facility reached out to find new collateral or credit support in the form of guarantees. With the globalization of business, many domestic businesses expanded their operations to Europe and other offshore locations. Lenders soon realized that this was a source of additional collateral. This new collateral pool will continue to be investigated by lenders. However, as discussed below, the perfection of the lender's lien is far more complex than the filing of a UCC-1 Financing Statement or the other traditional methods of perfection available under U.S. law.

## The Setting

You are the General Counsel of the Borrower which is located in Rochester, New York, with a Subsidiary in Bonn, Germany which handles the sale of products in Western Europe, which are stored at various locations. This morning you get an urgent email from the CFO to the effect that the lenders want to obtain the guaranty of the Subsidiary and a lien on all of the inventory located in Europe. The CFO needs a memo as to what must be done to satisfy the lenders. What do you need to know to prepare the memo?

### Fact Gathering

Before responding you must gather the essential information:

- The address of each warehouse where inventory is located.
- Is the inventory at each location owned by the Borrower or the Subsidiary?
- The place of "formation" of the Subsidiary and its address, officers and directors.
- Obtain an English translation of the Subsidiary's formation documents.
- Name of Subsidiary's counsel and contact person.
- Obtain the most current financial statements of the Subsidiary.
- Determine if the collateral is subject to a lien.
- Determine the value of the inventory at each location.
- Review existing credit documents to determine if the Borrowing Base includes the offshore collateral.

Why do you need all of this information? You must analyze the problem from the perspective of both the lender and the Borrower. Lenders are only concerned with acquiring additional collateral to support their credit exposure, without significant concern for the cost in doing so, as the Borrower foots the legal expense. This can be considerable as local counsel must be retained by the Borrower. If the collateral is located in jurisdictions outside of the Subsidiary's domicile more than one law firm must be retained. The reason for this is very straightforward. The lender wants assurance that (i) the Subsidiary is duly qualified, is in good standing and is authorized to guarantee and grant a lien on the collateral owned by it, (ii) the guaranty and lien are each enforceable under local law, (iii) the lien has been duly perfected, (iv) the selection of the law and forum provided in the loan agreement are enforceable and (v) the transaction does not require the lender's registration under local law. However, each individual lender's counsel may in addition require coverage of the matters discussed below.

The Borrower's response is somewhat more complex. From the Borrower's viewpoint, it wants to accommodate the lender, but on a cost effective basis. First, if the value of the offshore collateral is relatively low in conjunction with the attendant legal costs, the Borrower should bring such to the lender's attention. If the Borrower's loan availability under the existing credit facility is computed on the basis of a Borrowing Base of "Eligible Inventory or Accounts," the Borrower should request that the offshore collateral be deemed "Eligible" and included in the Borrowing Base.

If the Borrower has no leverage, due to a distressed financial position, it may have no alternative, no matter the cost, than to comply with the lender's demands. That is where you, as internal counsel, can be of assistance, in the preparation of the requested memo.

## The Memo

In addition to alerting the CFO of the above issues your memo should focus on the following:

- the necessity of the retention of local counsel and the attendant legal fees;
- request that lender provides a template of the requested offshore legal opinion, which should be forwarded to local counsel for review;
- alternatives to the perfection of liens under local law;
- the potential adverse tax consequences to the Borrower resulting from the guaranty by the Subsidiary, the granting of a lien by the Subsidiary or perhaps the pledge of all or part of the Borrower's ownership interest in the Subsidiary.

The balance of this article will focus on the above bullet points.

### Offshore Legal Opinion

The first task is to determine if the Subsidiary's local counsel has a conflict with the lender. Many of the major offshore law firms have extensive contacts with U.S. lenders and a waiver may be required.[2] As noted above the proposed form of legal opinion should be obtained from the lender and reviewed by the Subsidiary's counsel. If the requested opinion cannot be rendered, this should be immediately brought to the Lender's attention. Lender's counsel will (in addition to the assurances described above) have a checklist of matterS to be answered in the local counsel's opinion, as follows:

- licensing and qualification of lender in offshore jurisdictions;
- legal prohibition against the Subsidiary's guaranty and / or grant of collateral;
- manner in which lender's lien is to be perfected;
- does perfection cover after acquired collateral, as provided in the UCC;
- tax consequences to lender;
- priority of lien;
- enforcement of lien in the event of default;
- recognition of U.S. judgment against Subsidiary;
- bankruptcy under local law;
- effect of local withholding taxes.

From the above it is obvious that local counsel must be experienced in financing transactions in order to render a legal opinion in form and substance acceptable to the lender. The legal opinion is a crucial concern to U.S. lenders and should be addressed early on in the transaction and not left to the final days prior to closing.

### UCC Article 9 Perfection

Up to this point we have examined the issues of offshore financing essentially from the "belt and suspenders" position of the lender. As is apparent this approach presents more complexity and additional costs which most CFOs will find unpalatable.

The memo should make it clear that there may not be any alternative, but should suggest an alternative course of action to be offered to the lender. Direct the lender's counsel to Section 9-307 of the UCC. Section 9-307(c) establishes an "equivalency test" that provides that if the foreign lien statutes are essentially equivalent to the UCC then the lender is to follow the local laws of the foreign jurisdiction. If that is not the case, then the Subsidiary is deemed located in the District of Columbia and a UCC-1 Financing Statement filed there will perfect the lender's security interest in assets of the Subsidiary even if those assets are located offshore. The determination of whether or not an offshore country's secured lending statute meets the "equivalency test" has been the subject of much commentary by legal scholars and practitioners.[3] Your position should be that the legal analysis required in this regard is problematic at best and the filing in the District of Columbia is the surest and most cost effective method of perfecting the lender's lien.

Borrower should anticipate that lender's counsel may resist this scenario. In support of its position, the lender will probably raise the following objections: (1) it cannot be assumed the foreign local courts will enforce a security interest perfected under the UCC as in effect in a U.S. jurisdiction; (2) some foreign jurisdictions do not recognize a security interest in some of the types of collateral covered by a UCC-1 Financing Statement; and (3) a foreign local court may not recognize the selection of the UCC as the governing law for the perfection of liens.

The bottom line is that it is worth the effort to make this proposal in conjunction with a legal opinion (no matter how qualified) of U.S. counsel that the District of Columbia filing is sufficient.

### Tax Consequences

Are there any other issues raised by the Subsidiary's guaranty or the pledge by the Borrower of its ownership interest in the Subsidiary? By blindly permitting the Borrower to do either or both, in-house counsel may subject the Borrower to significant adverse income tax consequences. The profits of an offshore entity owned by a U.S. borrower are not taxable, provided that such profits are not repatriated by way of dividends or other distributions to the U.S. borrower. However, in the context of financing transactions, this loophole was substantially restricted by the enactment of Section 956 of the Internal Revenue Code and the regulations promulgated thereunder.

There are now three trigger events that result in the accumulated earnings of a foreign subsidiary being treated as a taxable "deemed dividend" to its U.S. parent:

(a) a guaranty by the offshore subsidiary, (b) a pledge of 66-2/3% or more of the offshore subsidiary's voting stock plus negative covenants restricting the foreign subsidiary's ability to dispose of assets or incur indebtedness, or (c) the granting of a lien by the foreign subsidiary on its assets to secure the loan to its U.S. parent. There are limitations on the amount of the "deemed dividend" and with expert tax planning the adverse tax consequences of Section 956 may be ameliorated. Whether or not there is a tax liability is dependent on numerous factors, including a determination if any foreign earnings have been previously taxed to the Borrower under other applicable tax statutes.[4] The Borrower may also propose that an unsecured guaranty of the Subsidiary together with the Borrower's pledge of a controlling interest in the Subsidiary provides adequate assurance to the lender.

## Conclusion

The Borrower with the able support of internal counsel and its external tax and legal advisors, may be in a position to suggest a sensible and more cost effective alternative to the comprehensive request of the lender with respect to the Borrower's offshore operations as part of the credit package and which still provides protection to the lender. If this approach fails, at least your memo will have provided a clear road map as to the issues to be dealt with and the costs involved.

## Endnotes

1. The theme of this article has been dealt with in more detail in the author's webinar and monograph "Drafting a Security Agreement for an Offshore Borrower or Collateral," Reed Logic (2007) and "Financing for Offshore Operations," New York Law Journal, (October 26, 2009).
2. An excellent source of qualified legal counsel in many foreign jurisdictions can be found in the recently published "Guide to Foreign Law Firms," available from the American Bar Association.
3. The most prominent scholar in this area is Professor Arnold S. Rosenberg, whose many articles are available on www.ababusinesslaw.org. See also his article "Where to File Against Non-U.S. Debtors," 39 U.C.C.L.J. 109 (2006).
4. Daniel G. Crumbaugh and Joseph M. Kronsnoble, "Avoiding Section 956 of the Internal Revenue Code," The Secured Lender, March/April 2005 (providing a detailed road map to the tax issues raised by Section 956 and the preparation of loan documentation to limit the impact of "deemed dividends").

**Sidney S. Goldstein is a partner in McCarter & English LLP's Corporate, Securities and Financial Institutions Group practicing in New York City. Mr. Goldstein focuses on banking, asset-based lending and creditors' rights. He is also the author of the treatise *Loan Agreements* published by Lexis/Nexis.**

# Intellectual Property Issues for In-House Counsel: A Report from the Annual Meeting

By Melissa Y. Wu

On January 26, 2011, the New York State Bar Association Corporate Counsel Section presented *Intellectual Property Issues for In-House Counsel* at the Annual Meeting. The panel of speakers included Robert J. deBrauwere, a Partner at Pryor Cashman LLP who specializes in the areas of digital media, intellectual property, trademarks, copyrights, entertainment, publishing, prepublication counseling, video gaming and licensing; Barbara Kolsun, Executive Vice President and General Counsel of Stuart Weitzman Holdings, LLC, the luxury shoe company, and Jay L. Monitz, Group Vice President and Associate General Counsel of Macy's Inc. and prior Chair and Executive Committee member of the NYSBA Corporate Counsel Section. Rachelle Stern of the Macy's Law Department moderated the panel.

**Left to right: Robert deBrauwere, Jay Monitz, Rachelle Stern and Barbara Kolsun**

Intellectual property issues related to copyrights, trademarks, and patents are becoming increasingly important to in-house counsel in this age of instantaneous business transactions and the ready dissemination and exchange of information. This year's Corporate Counsel Section Annual Meeting Program highlighted the particular intellectual property issues facing in-house counsel. The panel explored methods by which in-house counsel can brand their organization and protect products, information, and resources.

## Patent Law Issues

Mr. Monitz discussed patent trolls, a term used to refer to individuals and other entities that aggressively and opportunistically enforce their patents against one or more alleged infringers, often with no intention to manufacture or market the patented invention. He pointed out that such lawsuits initiated by patent trolls result in enormous defense costs for companies targeted and that the overwhelming majority of such cases settle. Thus, patent trolls stand to benefit by a large margin by bringing such lawsuits while defendant companies stand to lose large amounts of money by defending such matters. Further, Mr. Monitz noted that such patent lawsuits are not likely to be covered by insurance policies. Regarding steps that can be taken by in-house counsel of companies defending such actions, Mr. Monitz stressed the importance of analyzing contracts and agreements for rights to indemnification, particularly in actions where the defendant is a retailer accused of selling a patented invention. All analyses of agreements must be swift in order to avoid short notice and pleading deadlines. In cases where indemnification is unavailable or insufficient, defendant companies face great expense in either settling with the patent troll or satisfying a judgment. Even if indemnity is available to a defendant, suits brought by patent trolls potentially present numerous subtle and case-specific complications. In some actions, early settlement is much less expensive and is thus preferred over later settlement. Patent trolls present many challenges for in-house counsel of defendant companies, and counsel must act quickly and effectively to cut their companies' losses. In closing, Mr. Monitz briefly discussed the possibility of legislative changes designed to make patent troll lawsuits more difficult to initiate.

## Copyright Termination Issues; Social Media Advertising

Mr. deBrauwere continued the Annual Meeting with an overview of copyright issues. He outlined the sources of, duration of, and theories underlying copyright protection and requirements for copyright protection. Mr. deBrauwere also reviewed the types of works entitled to copyright protection, exclusions from copyright protection, copyright owners' rights and limitations thereon, and registration requirements. The copyright overview concluded on the topic of transfer and termination of licenses and copyrights under the U.S. Copyright Act. Mr. deBrauwere then segued into a deeper discussion of the termination provisions of the U.S. Copyright Act, to wit, 17 U.S.C. § 203 and 17 U.S.C. § 304. Key differences between the two provisions were highlighted.

17 U.S.C. § 203 covers grants of copyright made on or after January 1, 1978 and only covers grants of copyright made by the author of the work, not by his/her heirs. Under § 203, transfer may be terminated between the thirty-fifth and fortieth year after execution of the transfer and the earliest possible termination date is January 1, 2013. In contrast, 17 U.S.C. § 304 applies to works whose copyright was executed before January 1, 1978 that are in either their first or renewal term of copyright as of January 1, 1978. Under § 304, the right of termination is extended to grants made by the author's heirs or executors. Termination under § 304 may be effected on the later of two dates: 1) at the end of 56 years from the date copyright was originally secured, or 2) January 1, 1978. Further, under § 304(d), works whose termination right had expired by October 27, 1998, termination may be effected between 75 and 80 years from the date copyright was originally secured. Thus, termination under § 304 can presently be effected whereas January 1, 2013 is the earliest it can be effected under § 203. Mr. deBrauwere pointed out that the termination dates of §§ 203 and 304 create a loophole: § 203 covers works subject to a grant executed after January 1, 1978 while § 304 covers works subject to a grant executed before January 1, 1978, but created before such date. This begs the question: Are works subject to a grant executed before January 1, 1978 but created after that date covered under § 203 or § 304? The Copyright Office has sought public comment on this question but it is yet unresolved. Another question has arisen regarding what constitutes an agreement blocking the termination of a copyright grant under §§ 203 and 304. Mr. deBrauwere outlined case law wherein this issue was litigated that set forth the types of agreements that operated to block termination.

The speaker then switched gears to the timely topic of social media advertising. Social media covers platforms such as social networks (Facebook, MySpace), blogs, microblogs (Twitter, Foursquare), video sharing (YouTube), and virtual worlds. Mr. deBrauwere discussed the Federal Trade Commission (FTC) guides regulating advertisement in social media. The guides regulate endorsements, defined as advertising messages consumers are likely to believe reflect personal opinions or experiences of an individual or organization other than the advertiser. Such endorsements may consist of verbal statements, demonstrations, depictions of identifying characteristics of an individual, such as a name, signature, or likeness, or the name or seal of an organization.

The FTC guides state that endorsements must reflect the honest opinions, findings, beliefs, or experience of the endorser and may not convey any representation that would be deceptive if made by the advertiser. The guides also require the disclosure of any material connection between an advertiser and its endorser. A material connection is defined as one that could impact the weight or credibility a consumer gives to the endorsement. Examples of such material connections include items of value given to an endorser by the advertiser (cash, free products, prizes, etc.) or a relationship between the endorser and advertiser, such as employment. Mr. deBrauwere continued to state that under the FTC guides, all parties, including advertisers and their agencies, brands/companies, and bloggers may be liable to failure to disclose such material connections as well as the endorser making unsubstantiated claims about the products or services of the advertiser or brand.

The FTC also requires advertisers and brands to develop policies to educate their agents and endorsers about their responsibilities and monitor their statements and claims. Regarding endorsements, such brand policies should require endorsers to make statements reflecting honest opinions, findings, beliefs or experiences and not make deceptive or misleading claims about products or services. The endorser must also be a bona fide user of the product or service at the time the endorsement is made. Claims, explicit or implied, must not be unsubstantiated; they must be backed up by adequate proof. Endorsers should also be provided with pre-approved claims about products and any other claims should be approved before they are used. Mr. deBrauwere continued to point out that such disclosure may be difficult on social networking platforms that limit the number of characters of each message, such as Twitter. In such instances, hashtags (such as #ad) may be used, as well as "cmp.ly" for third party sources. On blogs, disclosure can be accomplished through the home page biography of the blogger. Every product-related blog entry or photo should also include disclosure. The same is applicable to video blogs, or "vlogs." When endorsers post their own opinions and comments about products or services, they should disclose that their views do not necessarily represent those of the company. Mr. deBrauwere concluded his exploration of social media advertising by noting that rules of general internet etiquette are always applicable. For example, hostile, harassing, violent, bigoted, fraudulent or otherwise offensive matter should always be avoided, as should the promotion of illegal or unsafe activities. Posting policies and terms of use should be followed. Lastly, advertisers and endorsers should always practice honesty, accuracy, good judgment, respect for others, and be aware that social media are not private.

# Section Events

## Trademark and Branding Issues

The final presenter at the Annual Meeting was Barbara Kolsun who examined trademark and branding issues for in-house counsel. Her presentation focused on such issues in the fashion industry but the principles are applicable to any company that produces goods or deals in brand names or commercial impressions. Intellectual property law provides legal protection for a number of commercial vehicles for a company and its products. A company's brand names and logos are considered trademarks. Its designs, photographs, and advertising text may be copyrighted. Its technical inventions and processes may be patented and its secret techniques can be considered trade secrets. Trade dress—non-functional features of a product's packaging, appearance, or configuration that contributes to its image—are also protected. The look or form of a product is protected if the public has come to recognize that look as originating from a specific source. Ms. Kolsun explored trade dress in the context of shoe, handbag, and retail store designs. A trade secret, on the other hand, is confidential business information kept private and guarded within a company. A common example of a trade secret cited by Ms. Kolsun was the fragrance used to scent perfumes, shampoos, detergents, and cleaning products. Ms. Kolsun moved on to discuss the Innovative Design Protection and Piracy Prevention Act, a bill introduced by Senator Chuck Schumer aimed at amending standards for design protection. This was compared with design protection in the European Union through its Design Directive. Ms. Kolsun continued to the topic of licensing. Companies license in order to increase their brand exposure and revenues for relatively little risk and overhead. In the fashion industry, designers often offer complementary products to their clothing lines, such as fragrances, jewelry, footwear, and accessories. To be successful, licenses have to be consistent with the designer's brand image. On the other end, licensing is beneficial for manufacturers because licensed products are more likely to be bought by retailers. Ms. Kolsun then discussed liability for trademark infringement, including liability of third parties. Third parties could be liable for infringement based on their level of knowledge and control over infringing transactions. For marks that are well-known and widely recognized, the mark holder need only prove a likelihood of dilution, which may take the form of making the famous mark less distinctive or harming the reputation of the famous mark by associating it with other goods. Ms. Kolsun noted that parody is among the fair use exceptions to infringement and dilution and outlined cases wherein famous marks were parodied. Next, name and likeness agreements were discussed and Ms. Kolsun noted that many designers have conveyed their individual rights to use their names. The presentation concluded with a discussion of counterfeiting, an aggravated form of infringement in which a party deliberately and knowingly misappropriates the intellectual property of another company. In-house counsel play an important role against counterfeiting, including formulating anti-counterfeiting strategies and protections. Additionally, counterfeiting is subject to criminal penalties and law enforcement officials collaborate with corporations and their in-house counsel, as well as legislators and trademark owners, to fight the problem of counterfeiting.

The presentations of Mr. deBrauwere, Ms. Kolsun, and Mr. Monitz highlighted current intellectual property issues facing in-house counsel and explored methods by which in-house counsel can brand their organization and protect its products, information, and resources. All three presenters provided fascinating analyses of the patent, copyright, trademark, and branding issues of which in-house counsel should be aware and ready to tackle. The Corporate Counsel Section thanks the speakers and the planning committee for their contributions and looks forward to presenting more such informative events in the future.

**Melissa Y. Wu, Esq. is a member of the Corporate Counsel Section and an Associate with the firm of Shafer Glazer, LLP in Manhattan. The firm's practice is focused on Corporate Counsel work for small and midsize companies and Insurance and Corporate Liability Defense.**

### Planning Committee

**Howard S. Shafer, Esq., Shafer Glazer, LLP, New York, New York * Rachelle Stern, Esq., Macy's Inc., New York, New York * Anne Atkinson, Esq., Pryor Cashman LLP, New York, New York * Melissa Y. Wu, Esq., Shafer Glazer, LLP, New York, New York * Timor Lahav, Benjamin N. Cardozo School of Law.**

# Section Events

## Corporate Counsel Section Holds Annual Fall Ethics Program


**Michael S. Ross, Andral N. Bratton, and John K. Villa expound on ethics for corporate counsel**

The Corporate Counsel Section held its Fall Meeting on November 12, 2010 at The Concierge Conference Center in New York City. The program was organized by Steven G. Nachimson, Program Chair, as well as the New York State Bar Association's Meetings Department. The meeting featured a seminar titled "Ethics for Corporate Counsel 2010: Current Issues and Best Practices." This marked the eleventh annual presentation of an Ethics program by the Section. Attendees received four hours of CLE credit, sufficient to meet the New York MCLE requirement for experienced attorneys in the field of ethics and professionalism for a full two-year reporting cycle, and also fulfilled one year's MCLE requirement for newly admitted attorneys.

The featured panelists were Andral N. Bratton, Principal Attorney with the Appellate Division, First Department; Michael S. Ross of the Law Offices of Michael S. Ross; John K. Villa of Williams & Connolly; James Q. Walker of Richards, Kidde & Orbe, LLP, and Professor Ellen Yaroshefsky of Cardozo Law School, Jacob Burns Ethics Center.

The panel addressed an array of ethical issues of particular concern to corporate counsel, including use of improperly obtained evidence by or against a corporation, responding to threats of blackmail against the corporation, and participation by attorneys in investigations. The speakers also discussed preservation of the attorney-client privilege when engaging public relations firms, as well as other recent trends affecting the attorney-client privilege. In addition, the panelists addressed multijurisdictional practice and the proposed limited licensing of attorneys who are admitted in another jurisdiction and are employed as in-house counsel in New York. The timeliness of the Ethics program was highlighted by the indictment, just days before the event, of a former attorney with GlaxoSmithKline, on obstruction charges pertaining to a federal investigation.

## Member Appreciation Event

**December 8, 2010 Member Appreciation and Networking Event hosted by Gary Roth and BMI at their offices in downtown Manhattan.**

**Two Guests Deep in Conversation**
Copyright 2010 by Gary Gershoff/NYSBA

**Executive Committee member Sarah Feingold and guest enjoying the festivities**
Copyright 2010 by Gary Gershoff/NYSBA

# Corporate Counsel Section Committee Chairpersons

**CLE and Meetings**
Steven G. Nachimson
Compass Group USA, Inc.
3 International Drive, 2nd Floor
Rye Brook, NY 10573
steven.nachimson@compass-usa.com

Howard S. Shafer
Shafer Glazer LLP
90 John Street, Suite 701
New York, NY 10038-3202
hshafer@shaferglazer.com

**Diversity Internship**
David S. Rothenberg
Goldman Sachs
200 West Street, 40th Floor
New York, NY 10282
david.rothenberg@gs.com

**INSIDE/ Publications Committee**
Janice Handler
handlerj@aol.com

Allison B. Tomlinson
Gensler
1230 Avenue of the Americas
Suite 1500
New York, NY 10020
allison_tomlinson@gensler.com

**Membership**
Thomas A. Reed
1172 Park Ave., Suite 15-c
New York, NY 10128
tomreed2@me.com

**Pro Bono**
Steven H. Mosenson
The Center for Discovery
P.O. Box 840
Harris, NY 12742
smosenson@sdtc.org

**Technology and New Media**
Fawn M. Horvath
Macy's, Inc.
11 Penn Plaza
11th Floor
New York, NY 10001
fawn.horvath@macys.com

NEW YORK STATE BAR ASSOCIATION
CORPORATE COUNSEL SECTION
One Elk Street, Albany, New York 12207-1002

ADDRESS SERVICE REQUESTED

NON PROFIT ORG.
U.S. POSTAGE
**PAID**
ALBANY, N.Y.
PERMIT NO. 155



*Inside* is a publication of the Corporate Counsel Section of the New York State Bar Association. Members of the Section receive a subscription to the publication without charge. Each article in this publication represents the author's viewpoint and not that of the Editors, Section Officers or Section. The accuracy of the sources used and the cases, statutes, rules, legislation and other references cited is the responsibility of the respective authors.


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

# Inside

## Section Officers

**Chairperson**
Gregory H. Hoffman
BT Americas Inc.
620 Eighth Avenue
New York, NY 10018
greg.hoffman@bt.com

**Chairperson-Elect**
David S. Rothenberg
Goldman Sachs
200 West Street, 40th Floor
New York, NY 10282
david.rothenberg@gs.com

**Vice-Chairperson**
Howard S. Shafer
Shafer Glazer LLP
90 John Street, Suite 701
New York, NY 10038-3202
hshafer@shaferglazer.com

**Secretary**
Sarah M. Feingold
Etsy Inc.
55 Washington Street, Suite 512
Brooklyn, NY 11201
sarahfeingold@gmail.com

**Treasurer and Vice-Chairperson**
Jeffrey P. Laner
Battery Park City Authority
One World Financial Center, 24th Floor
New York, NY 10281
jlaner@nyc.rr.com