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Focus On International Trade

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UNCITRAL Arbitration Rules and Confidentiality: Time for a Change? p.11 >>

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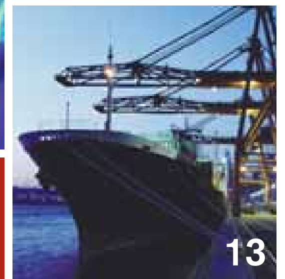

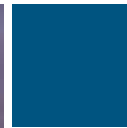

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In This Issue

Welcome to the last issue of *International News* for 2006. In this edition, we focus on international trade, revealing new policies and highlighting issues of interest to international and national companies alike. We also cover a number of other interesting and topical subjects.

In our features section, we take a look at the wave of consolidation and privatisation in the European health care industry. Europe appears to be following the trend of the United States in this respect and there are lessons to be learned and opportunities to be pursued. Staying in European infrastructure, regular contributors Dr. Oliver Steffens and Vincent Schröder examine how changes to German procurement laws are having a mixed effect on the efficient use of public money for large projects. The changes have been both a success and a failure.

We move then to finance and examine how U.S. companies can make the most of London's junior market, AIM, by re-domiciling and crafting their offer structures. The benefits of floating on AIM were discussed in *International News,* Issue 1, 2006. If you would like a copy of this article, please contact Sarah Hargrove at shargrove@europe.mwe.com. William Yonge examines the implications of Markets in Financial Instruments Directive (MiFID) on UK investment firms and recognised investment exchanges. MiFID, which comes into effect on 1 November 2007, will replace the Investment Services Directive (ISD).

Juliet Blanch and John Rhie take a look at the changes to the UNCITRAL arbitration rules and how these affect confidentiality—a perennial hot topic for arbitrations. Another hot topic, this time in the energy sector, is the realisation that there is a huge potential for conflict between the Kyoto Protocol and WTO regulation. It seems that free trade may hinder environmental policies. Conversely, countries need to be prevented from using Kyoto to further protectionist interests.

In our focus on international trade, our Head of International Trade, Carolyn Gleason, and partner Pamela Walther start with a forward thinking review of "The Outlook for Trade Liberalisation and Beyond". David Baron subsequently looks at how businesses can attract more investment into new markets by providing a safety net in the form of pre-emptive arbitration agreements.

It is little known that U.S. rules on technology and intellectual property export have an impact on international companies undertaking research and development in the United States and licensing and exploitation elsewhere. In "Inventors Beware U.S. Export Controls", we look at the procedures that must be followed in order to avoid significant penalties.

In "Proposed U.S. Congressional Action Against China" and "New Policy Overturns Traditional EU Anti-Dumping Practice", we take a look at the policies the United States and the European Union are putting in place in order to establish some protection against the lower-cost production countries in the Far East.

Finally, Ian Rose and Helen Bignall examine the hard line that the European Commission is taking against the promotion by some individual EU Member States of "national champions".

If you have any comments on this issue or would like to contribute to *International News,* please do not hesitate to contact me.

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The Next Wave of Consolidation and Privatisation in European Health Care Investments

By **Monte Dube** and **Dominic Hollamby**

If imitation is the highest form of flattery, then U.S. health care providers might well be flattered by the recent, unprecedented spate of multi-billion dollar mergers taking place in the European marketplace.

Even casual observers of the U.S. health scene are aware of the magnitude of this segment of the U.S. economy. Health care spending accounts for almost 16 per cent of the U.S. gross domestic product, approximating U.S.$2 trillion annually. The diverse landscape includes nearly 5,000 hospitals and thousands of nursing homes, assisted living centres and continuing care retirement communities. It also includes increasing numbers of outpatient care facilities, including ambulatory surgery centres, diagnostic imaging centres and the like. Ambulatory health centre growth will continue to explode as evolving technology enables an increasingly broad array of diagnostic and therapeutic procedures to be performed safely and effectively outside the hospital setting.

Increasing numbers of America's almost 600,000 physicians are investing in health care facilities to supplement their fee for service income by "skimming the cream" of the highest reimbursed medical technologies. Many states permit ambulatory care services to be provided by private parties with relatively low regulatory barriers to entry, thus hospital-physician joint ventures are becoming a commonplace method to create "win-win" business arrangements between these potential competitors.

For the last two decades, the U.S. hospital industry has consolidated into numerous health care systems, spurred in part by the Medicare Program's 1983 implementation of a "Prospective Payment System" (PPS) which encouraged efficiency in health care delivery and incentivised shorter inpatient hospital stays. Hundreds of government-owned and -operated hospitals have "privatised". They have transferred operational responsibility from instrumentalities—cities, counties, districts, *etc*—to non-governmental operators. This generated cash from hard assets and going concerns in order to ameliorate budgetary shortfalls and address capital improvement needs.

At the time of going to press, seven U.S. publicly traded hospital companies operate more than 500 hospitals and have a combined market capitalisation of U.S.$42 billion. Earlier in 2006, the largest of these companies, HCA Inc., which owns 182 hospitals and 94 ambulatory surgery centres (including several in the United Kingdom and Switzerland), announced the largest leveraged buyout in U.S. history. This was a U.S.$33 billion "going private" transaction, calculated as a multiple of eight times last year's earnings before interest, taxes, depreciation and amortization (EBITDA). It was viewed by some as buying HCA "on the cheap", at a discount to HCA's historic valuations.

Europe Catches the Wave

The last year has seen an unprecedented wave of health care consolidation and privatisation throughout Europe. During the fourth quarter of 2005, Fresenius Medical Care AG & Co. KGaA, a global hospital and renal dialysis operator, paid €1.5 billion to acquire 24 German hospitals owned by Helios Kliniken GmbH, a private operator of 9,300 hospital beds. Notably, Germany's 2,000 hospitals became subject in 2003 to a diagnosis-related group (DRG) system of compensation based, in large part, upon the U.S. PPS model. As in the United States, the German PPS incentivises efficient and cost-effective delivery of integrated health care on an interdisciplinary basis. If the post-1983 U.S. experience is any guide, many German hospitals, the vast bulk of which are public, can be expected to struggle with the adjustment to the competitive model of health care service delivery. This will make them attractive acquisition targets to purchasers such as Fresenius.

In April 2006, Network Healthcare Holdings (Netcare), a Johannesburg-based publicly traded company and the largest integrated private health care organisation in Southern Africa, led a consortium of three UK-based financial and property investors. The consortium consisted of Apax Partners, one of the world's largest private equity firms, London & Regional Properties, one of the largest private property companies in Europe, and Brockton Capital Partners LLP, a UK-only opportunity fund. They acquired General Healthcare Group (GHG) for £2.2 billion, representing an historic 15x EBITDA multiple. GHG, a national network of 49 hospitals, was the largest operator of independent private acute care in the

United Kingdom. Netcare is one of the world's largest health care groups, with 120 hospitals and ambulatory centres totalling more than 11,500 beds.

> Buyers view the market as attractive because health care businesses are cash-generating, with relatively simple business models and stable cash flows.

Apax Partners did not stop with the GHG acquisition. In September, 2006, Apax and Stockholm-based Nordic Capital made an unsolicited offer to acquire Capio AB, a Swedish publicly traded hospital company founded in 1994. Following rapid growth through acquisitions, Capio became Europe's second largest and only truly Pan-European independent provider of acute care services, operating 100 hospitals in Sweden, Norway, Denmark, Finland, the United Kingdom, Germany, France and Spain. The Capio board accepted an enhanced cash offer of €2.7 billion in October. The proposed transaction is the largest ever health care public-to-private deal in Europe and second largest public-to-private deal across all sectors in Sweden.

The Drivers

The impetus behind this unprecedented European health care consolidation includes many of the same factors which have been driving such transactions in the United States for the last 25 years. Buyers view the market as attractive because health care businesses are cash-generating, with relatively simple business models and stable cash flows. Health care is the largest industry in any developed economy—in EU countries it ranges from 8 to 12 per cent of the GDP—with high and accelerating growth. Health care services span a broad continuum from cradle to aging to grave. Health care markets throughout Europe, as in the United States, remain highly fragmented and specialised, and therefore ripe for continued consolidation and increased efficiencies and economies of scale.

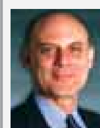
As the baby boomer generation continues to age, demand for high quality and timely health services, paid for by private insurance or by the individuals themselves, will increase. The demand is powered by increasingly sophisticated and affluent consumers who seek to make more informed, internet driven medical choices.

These increased patient demands mirror, or more likely are the catalyst for, increasingly supportive European governmental regulatory attitudes towards the independent sector, which is driving improved quality and accessibility. Politicians throughout the European Union are bemoaning the historic relative under-investment in health care that has caused Europe to fall significantly behind the United States and Japan in many key health care benchmarks.

UK pressures on governmental health authorities mean that much of the increase in demand will be satisfied by the independent health sector. In response, the Department of Health in June 2002, published the "Growing Capacity Initiative", known as the Independent Sector Treatment Centre (ISTC) Program. The Government called for the private sector to increase the capacity of health care services in the United Kingdom. This is much to the concern of some UK residents who view the increasing number and success of ISTCs as proof that the National Health Service is withdrawing from the provision of health care services to focus on funding instead.

> UK pressures on governmental health authorities mean that much of the increase in demand will be satisfied by the independent health sector.

Globalisation, for better and for worse, has come to the health care sector. It is inevitable that, in the coming decade, consolidation of the type and breadth experienced in the United States will find its way into Europe, and beyond. Opportunities abound for those who wish to invest in this huge, and still largely untapped, marketplace.



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German Procurement Laws in Flux

By **Dr. Oliver Steffens** and **Vincent Schröder**

In 2004, the European Union adopted two directives—2004/17/EC and 2004/18/EC—on the co-ordination of procedures for the award of public contracts. These were intended to modernise, simplify and increase the flexibility of European procurement law. Directive 2004/17/EC addresses the tendering of services primarily rendered by public utility companies. Directive 2004/18/EC deals with the invitation for bids regarding public works, supply and service contracts in general. It is therefore of interest to a broad scope of European market participants. Implementation of the regulations is expected to be finished in early 2007.

Background to the Reform

Procurement law requires the public authority to put out to tender merchandise and services while abiding by specific procedural rules. While the sound utilisation of public funds has long been a major objective of procurement law, the idea of protecting the rights of the bidders to equal treatment by ensuring transparency and providing corresponding judicial remedies was only introduced to German procurement law towards the end of the 1990s as a result of EU legislation.

Since the legislation only applies where the net value of the contract tendered exceeds specific thresholds (for example, €5 million for works contracts or €200,000 for regular service contracts), German procurement law is affected by a dichotomy which has severe consequences for potential bidders.

Unless the net value of the contract exceeds the applicable threshold, the public authority is obliged to observe only a very limited set of contracting rules, the *Verdingungsordnungen* (known as VOB for construction contracts and VOL for services and supplies), which are primarily designed to ensure effective utilisation of public funds. Since the disposal of public money does not affect any individual rights, the bidder has only a very few options

to seek judicial relief in the case of an alleged violation of the applicable contracting rules.

If, however, the value of the contract tendered surpasses the applicable threshold, VOL, VOB and the contracting rules exclusively applicable to freelance services exceeding the threshold, known as VOF, are complemented by the rather complex provisions of the German Act against Restraints of Competition, the *Gesetz gegen Wettbewerbsbeschränkungen* (ARC), and the corresponding Procurement Regulation, *Vergabeverordnung* (PR), based on the respective EC legislatory acts. These regulations, in particular, aim to protect the rights of the individual bidders and, therefore, provide them with extensive legal remedies.

> "The current reform of German procurement law exclusively refers to the tendering of contracts with a value exceeding the applicable threshold."

The current reform of German procurement law exclusively refers to the tendering of contracts with a value exceeding the applicable threshold. The ARC, PR, VOL, VOB and VOF are particularly affected. While the stated aim to merge the better part of the existing procurement provisions into a single consistent "Procurement Act" has not been realised due to time restraints, the projected revision of the available tendering procedures has commenced.

Key Aspects of the Reform

German procurement laws require public authorities to put services out to tender across the European Union according to a rather strict set of procedural rules. At the moment, three different tendering procedures are available to the public authority. Although, depending on certain prerequisites, these proceedings can vary, all of them require the participating bidders to be provided with precise specifications of the services required.

During the reform discussion, this requirement has frequently been criticised as inadequate as public authorities requesting tenders for extensive services are not usually capable of giving precise specifications due to their lack of expertise in that field. Examples of such services include the realisation of large infrastructure projects, the implementation of large-scale IT network solutions and the implementation of complex financing transactions. As a result, the competitive negotiation procedure, *Wettbewerblicher Dialog*, has been introduced for "exceptionally complex tenders". It provides for a preliminary stage in which all potential bidders must co-operate to determine the specific technical requirements of the public authority. The bidders then file their tenders based on the jointly developed specifications. As a result, the public authority can use external expert knowledge efficiently while at the same time giving bidders the clearest specification possible.

In addition to introducing this completely new tender process, a series of amendments and modifications is expected to be adopted in early 2007 with respect to all tendering procedures. Among other things, one or more public authorities are allowed to enter into framework agreements with one or more bidders, provided that this contract does not exceed a four-year term or improperly prevent, restrict or distort competition. This is meant to reduce the time and effort necessary to tender the corresponding individual contracts or to even supersede a separate tendering of such individual contracts. The new regulations also encourage the foundation of central purchasing bodies by different public authorities in order to enhance cost-effectiveness and ensure neutrality towards the bidders involved in a specific tendering procedure. Furthermore, the use of electronic means of communication during a tendering procedure has been initiated, thereby allowing foreign bidders to take part in the process more easily.

Achievements and Failures

Since the German legislator has not managed to merge the numerous statutory sources of German procurement law into a single coherent and generally understandable "Procurement Act" as originally planned, the attempt to simplify procurement law may well be considered as a failure. Moreover, introducing additional tendering procedures instead of reducing the rather large amount of existing, intricate tendering provisions has contributed to increased complexity.

> "It is yet unclear whether the underlying concepts will be put into practice."

As regards the adoption of competitive negotiation as a new tendering procedure, some degree of flexibility has certainly been achieved by exempting "exceptionally complex tenders" from the basic prohibition to negotiate tender specifications. However, numerous questions with respect to the competitive negotiation procedure are not dealt with by the respective statutory provisions and will have to be decided by the courts as they apply and interpret the law.

Finally, while such legal instruments as framework agreements, central purchasing bodies and eprocurement procedures undoubtedly advance and modernise the efficient tendering of required services, it is yet unclear whether the underlying concepts will be put into practice.

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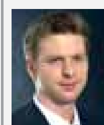

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Re-Domiciling and Offer Structures to Take Advantage of AIM

By Andrew Croxford

AIM, the junior London market, is becoming an increasingly popular choice for international companies. In addition to the issues faced by any company joining a public market, U.S. companies and, indeed, all international companies, need to address whether to float the existing overseas-domiciled entity or to re-domicile in the United Kingdom or another offshore jurisdiction.

Choice of Domicile

Nothing in the AIM Rules prevents an overseas entity from floating on AIM. U.S. issuers are thus now faced with a genuine choice of domicile. In making this choice, several factors may determine the outcome: the acceptability of a U.S. entity to the likely investors; the likelihood that an offshore vehicle (such as an English plc) may increase the group's profile and standing with its UK/European customers and suppliers; and, perhaps most decisively, the tax implications.

There are two ways for a U.S. company to re-domicile outside the United States. The first is through an "inversion" merger, where a direct or indirect offshore subsidiary of the existing parent becomes the holding company of its group. The second is by an exchange transaction, where shareholders of the existing parent are offered shares in a new, offshore holding company. The inversion merger is often preferable as only the statutory shareholder approval is required—usually a simple majority—so minority holdouts are futile. The consensual exchange may be preferable where shareholders unanimously support the transaction and other structural or financial modifications need to take place at the same time.

Re-domiciling requires detailed tax planning as there can be adverse tax consequences, such as exit charges on deemed capital gains. On the other hand, depending on the shape of future growth and profits for the enterprise as a whole, and their geographical distribution, re-domiciling may generate future tax benefits. In addition, over time and depending on the nature of the company and its business, using a non-U.S. holding company may also help to avoid future problems involving Securities and Exchange Commission (SEC) registration under the U.S. Securities Exchange Act.

Even if the analysis suggests that there is little or nothing to be gained by re-domiciling, a U.S. issuer should take advice on whether to make amendments to its constitution in order to mitigate concerns of UK investors by incorporating pre-emption rights on new share issues, certain provisions of the City Code on Takeovers and Mergers, and "UK-style" corporate governance standards. In addition, UK investors are likely to want to see the addition to the board of UK-based non-executive directors.

Offshore Offerings and U.S. Securities Laws

For U.S. securities law purposes, AIM IPOs are generally structured to comply with Regulation S under the U.S. Securities Act, which provides a "safe harbour" from registration with the SEC for offerings conducted outside the United States. That said, there is no reason, in principle, why an offshore offering cannot be combined with a U.S. offering under other safe harbours such as Regulation D and Section 4(2)/Rule 144A. Companies can successfully combine both onshore and offshore offerings in the context of their IPOs, gaining access to a U.S. investor base with the potential for resultant increased valuations.

The two overarching requirements for any Regulation S-compliant offering are that the offering is made offshore, and there are no "directed selling efforts" made in the United States (*ie,* activities which could condition the U.S. market).

Whether an offering is "offshore" is determined by where the bargain is struck. For example, even "U.S. persons" located in London can participate in the offering if it is made by a foreign issuer.

"Companies can successfully combine both onshore and offshore offerings in the context of their IPOs..."

"Directed selling efforts" encompasses a broad range of activities. These include mailing printed material to investors in the United States, conducting promotional seminars in the United States, placing adverts in publications with

general U.S. circulation and placing adverts with radio/TV stations broadcasting into the United States.

Under Regulation S, where a company is a "foreign issuer" and reasonably believes at the commencement of the offering that there is no "substantial U.S. market interest" in the class of securities being offered or sold, the transaction qualifies as a "Category 1" Regulation S transaction. It can then be made largely without other ongoing restrictions.

For these purposes, a "foreign issuer" means a "foreign private issuer" as defined in Rule 405 under the U.S. Securities Act. That is, an issuer which is a corporation or other entity incorporated or organised under the laws of a non-U.S. jurisdiction where either:

- Not more than 50 per cent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; or
- Each of the following criteria is met: the majority of the executive officers or directors are not citizens or residents of the United States; not more than 50 per cent of the assets of the issuer are located in the United States; and the business of the issuer is not administered principally in the United States.

As a result, re-domiciling a U.S. company is, of itself, unlikely in most cases to result in the new offshore holding company being a "foreign issuer" for Regulation S purposes. Any company that remains a "domestic issuer" must meet the more stringent requirements of "Category 3" of Regulation S.

Under Category 3, in addition to the overarching requirements described above, "offering restrictions" must be implemented and additional procedures maintained during a one-year "distribution compliance period" following the closing of the offering. Offers or sales made before the expiration of this period must generally not be made to or for the account or benefit of a U.S. person. They must also satisfy various other procedural requirements, including certifications, legending and transfer restrictions.

"U.S. companies must monitor their shareholder base regularly once they become publicly traded on AIM."

Physical Settlement

Complying with these requirements in the context of an AIM IPO currently means that Category 3 securities must be issued and traded in legended, certificated form, rather than be traded through the UK electronic settlement system known as CREST as required by AIM Rule 36.

This "physical settlement" requirement increases the cost and logistical burden of trading. An issuer of securities subject to Category 3 requirements seeking admission to AIM has, historically, needed to obtain a derogation from Rule 36. The London Stock Exchange recently announced an initiative with the Swiss settlement system operator, SIS SegaInterSettle AG, aimed at facilitating electronic settlement of Category 3 securities. Although the Exchange's efforts to resolve the situation are certainly welcomed, doubts remain as to whether this initiative fully complies with the prescriptive requirements of Regulation S, particularly the requirement that "the securities of a domestic issuer contain a legend to the effect that transfer is prohibited except in accordance with the provisions of this Regulation S, pursuant to registration under the [Securities] Act or pursuant to an available exemption from registration…" Any decision to use this means of electronic settlement should, therefore, be made only after taking legal advice. It is worth noting that the Exchange has agreed to continue providing a derogation from Rule 36 allowing continued use of paper-based settlement.

Securities Exchange Act Registration

One of the attractions of AIM for U.S. companies is that its regulatory regime is intended to be more appropriate for publicly traded small/mid-cap companies and that the administrative burdens and compliance costs of the Sarbanes-Oxley Act are avoided. However, both U.S. and non-U.S. companies can become subject to registration under the Securities Exchange Act if they are engaged in interstate commerce, have assets exceeding U.S.$10 million and have more than 500 shareholders. As a result, U.S. companies must monitor their shareholder base regularly once they become publicly traded on AIM. Companies with large workforces participating in share incentive schemes should consider replacing them with "phantom" schemes providing the economic benefit of share options without the actual shareholding.

Foreign private issuers (as defined above) can file for an exemption from registration under Rule 12g3-2(b) if, at the time the exemption is perfected, they have less than 300 U.S. resident shareholders. Although a re-domiciled U.S. company may not qualify as a foreign private issuer at the time of the IPO, it may become one over time. If so, the company would be well advised to perfect the exemption as soon as permissible.

Andrew Croxford is a partner in the Firm's London Corporate Department, where his practice focuses on equity capital markets. He advises underwriters and issuers on UK and international equity offerings, including IPOs, rights issues, open offers, private placings and issues of convertible/exchangeable bonds. He has substantial experience advising in the context of international companies accessing the UK capital markets. Andrew can be contacted on **+44 20 7577 6921** or at **acroxford@europe.mwe.com.**

The European Single Market—MiFID

By **William Yonge**

The Markets in Financial Instruments Directive (MiFID) was adopted on 30 April 2004, and comes into effect on 1 November 2007. At that time, it will replace the existing Investment Services Directive (ISD). MiFID will directly affect UK investment firms and recognised investment exchanges.

The Financial Services Authority (the FSA) is managing its UK implementation of MiFID as part of its planned radical review of existing requirements. It will remove rules that are no longer effective or proportionate and move away from detailed rules towards higher-level ones.

MiFID is a central element of the European Commission's Financial Services Action Plan which sets out a comprehensive regulatory regime covering investment services and financial markets in Europe. The Plan contains measures which will improve the organisation and functionality of investment firms, and facilitate cross-border trading. It will thereby encourage the integration of EU capital markets whilst ensuring strong investor protection.

MiFID comprises two levels of European legislation: the Directive itself, and implementing measures consisting of a directive and a regulation. In general, MiFID will cover most, if not all, firms currently subject to the ISD, plus some that are currently not; those covered will include investment banks, portfolio managers, stockbrokers and broker dealers, corporate finance firms many futures and options firms and some commodities firms.

In some areas, the position will not be clear. For instance, retail banks and building societies will be subject to MiFID for some parts of their business—*eg*, selling securities or investment products which contain securities—but not others.

Key Provisions

Investment advice and the operation of a multilateral trading facility (MTF) are brought within the scope of EU regulation and the single European passport provided by MiFID. Commodity derivatives, credit derivatives and financial contracts for differences are financial instruments for the purposes of MiFID, but not all firms trading commodity derivatives are within MiFID's scope.

Using the MiFID passport, firms incorporated and regulated in an EEA member state will be able to establish branches in other member states and offer cross-border services without having to satisfy local registration requirements in a wider range of cases than under ISD. MiFID clarifies some of the jurisdictional uncertainties under ISD by clearly delineating the allocation of responsibility between home state and host state.

Common standards for business conduct, which are extensive and will require significant changes to the FSA's Handbook, will be implemented. In particular, these will include the introduction of a new EU-wide client categorisation regime. MiFID speaks in terms of eligible counterparty, professional client and retail client, whereas FSA currently speaks in terms of market counterparty, intermediate customer and private customer.

MiFID's requirements on best execution will mean some important changes to the current FSA regime. Firms will be required to take all reasonable steps to obtain the best possible deal for their clients. They will have to take not just price into consideration, but other factors such as cost, speed and likelihood of execution and settlement.

There will be more detailed requirements governing the organisation and conduct of business of investment firms and how regulated markets and multilateral trading facilities operate. There are also new pre- and post-trade transparency requirements for equity markets; the creation of a new regime for "systematic internalisers" of retail order flow in liquid equities; and more extensive requirements for transaction reporting to regulators.

New minimum standards for recognised investment exchanges and alternative trading facilities will be introduced.

Most firms that fall within MiFID will also have to comply with the new Capital Requirements Directive which will set requirements for the regulatory capital a firm must hold. Firms newly covered by MiFID will be subject to directive-based capital requirements for the first time.

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UNCITRAL Arbitration Rules and Confidentiality: Time for a Change?

By **Juliet Blanch** and **John Rhie**

The UNCITRAL Arbitration Rules (UNCITRAL Rules) were adopted in 1976 by the UN Commission on International Trade Law (UNCITRAL). Since their inception in 1976, the UNCITRAL Rules have become the most popular rules for *ad hoc* and investment treaty arbitrations. They have stood the test of time and have never been amended. In the light of their 30th anniversary, revisions are being suggested to take into account developments in international law and investor–state relations.

Official proposals to amend the UNCITRAL Rules began in New York in June 2006 at UNCITRAL's 39th session. The UNCITRAL Secretariat (the Secretariat) tabled a paper that put forward 47 areas where changes to the UNCITRAL Rules might be considered. This paper was elaborated upon by a special report commissioned by the Secretariat. One of the most contentious proposals raised was regarding an issue which polarises opinion in the arbitration world: confidentiality.

> This possible increase in secrecy of UNCITRAL arbitrations has been met with criticism…

Confidentiality

Articles 25(4) and 32(5) of the UNCITRAL Rules already deal with the confidentiality of the oral hearings and written awards respectively. They are, however, silent in relation to the confidentiality of the proceedings *per se*, or of the materials, including pleadings before the arbitral tribunal.

The report commissioned by the Secretariat addresses this silence by proposing a new Article stating that "Unless the parties have agreed otherwise, all materials in the proceedings which are not otherwise in the public domain, including materials created for the purpose of the arbitration and all other documents or evidence given by a party, witness, expert, [or any other person] shall be treated as confidential, save and to the extent that disclosure may be required of a party by legal duty, to protect or pursue a legal right, and in *bona fide* legal proceedings before a state court or other judicial authority in relation to an award".

This proposed amendment would allow the UNCITRAL Rules to fall in line with various major arbitral institutions and rules which state that any materials used in an arbitration are confidential. These include the World Intellectual Property Organisation (Article 74(a)), the London Court of International Arbitration (Article 30.1) and the Swiss Rules of International Arbitration (Article 43(1)).

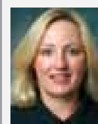
Transparency Concerns

As the UNCITRAL Rules do not require arbitrations to be registered or publicised, if the proposed amendment is implemented then even fewer claims will come to the attention of third parties who may be interested and affected by the dispute. This possible increase in secrecy of UNCITRAL arbitrations has been met with criticism from those who wish for greater transparency and public accountability.

Tackling the Issue

A possible solution to alleviate this concern is to allow the proposed amendment to apply to purely private international disputes but not to investment treaty disputes. Under these circumstances, states are effectively spending tax payers' money and the lack of transparency in the arbitration process is therefore an understandable concern. Another issue which would then need to be addressed is whether the proposed amendment would impact both multilateral investment treaty disputes as well as bilateral investment treaty disputes.

These issues will hopefully be considered by the time the draft set of revised rules is produced by the Secretariat and considered by the UNCITRAL Working Group in February 2007. It should become clear by then whether an appetite remains to broaden the issue of confidentiality for the UNCITRAL Rules.



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Potential Conflicts Between the Kyoto Protocol and the World Trade Organisation

By **Kari Larsen** and **Prajakt Samant**

The Kyoto Protocol is an international agreement setting targets for industrialised countries to cut their greenhouse gas (GHG) emissions. The World Trade Organisation (WTO) is an international body whose purpose is to promote free trade by urging countries to abolish tariffs and other equivalent measures. In other words, Kyoto has globalised the climate change agenda, and the WTO has come to represent globalisation itself.

Whilst Kyoto seeks to "protect and preserve the environment", the WTO urges signatories to "strive to implement policies and measures in such a way as to minimise adverse effects on international trade". Some observers worry that the free-trade institutions of the WTO could undermine Kyoto's environmental goals. There are a number of potential conflicts which may arise in the future.

Most-Favoured Nation

The Most Favoured Nation (MFN) Principle prohibits WTO members from discriminating among like goods from other members. If a country were to adopt "green" tariffs which discriminated against producers in certain Member States whilst favouring producers in other Member States, it could be violating the MFN Principle. If the discrimination favoured a "like product" from its domestic producers, the policy could be in contravention of Article 3 of the Global Agreement on Tariffs and Trade (GATT) for giving more favourable treatment to domestic producers. Article 20 allows exceptions to the non-discriminatory principles, if the measures taken are not a "means of arbitrary or unjustifiable discrimination" or a "disguised restriction on international trade". However, determining which circumstances are exceptions would be decided by a frequently critiqued international panel of experts.

If GHG emission allowances are classified as "services" in the future, limiting their trade to only Kyoto members and excluding the other WTO Members may also be in violation of the MFN Principle.

Environmental Taxes and Subsidies

If a tax is imposed on domestic "dirty" coal production, for example, it is reasonable that a similar tax is applied to such coal imported from other Member States. However, there is some uncertainty as to whether such a tax would be enforceable under GATT. Similarly, a ban on fossil fuel subsidies in one WTO Member State and not others may cause problems. It could be argued, though, that an outright ban on such subsidies by the WTO would achieve the dual goals of reducing emissions and removing economic contortions.

Environmental Standards

Whereas WTO Members may adopt any domestic GHG standards they choose, problems may arise under the WTO's Technical Barriers to Trade Agreement. This Agreement ensures parity among Members' standards in order to avoid favouring domestic products over foreign goods. Differing standards could be taken as exclusionary tactics for particular goods.

Conflict Among WTO Members

Critics have suggested that countries that have not ratified Kyoto, such as the United States or Australia, may have an unfair trade advantage since non-compliance with Kyoto would result in unfairly low energy costs. Some countries have threatened to use trade sanctions under the WTO to address the disparity. Governments which utilise their spending power to favour certain producers could potentially be in contravention of the Agreement of Government Procurement.

It is clear that climate change and international trade regimes have considerable overlap and, in many ways, can use common synergies to further their respective aims for win-win solutions. Should the potential conflicts outlined above arise, they are likely to force a further bifurcation of the environmental and international trade lobbies away from co-operation and towards self-interest.

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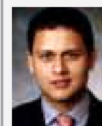

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The Outlook for Trade Liberalisation in 2007 and Beyond

By **Carolyn Gleason** and **Pamela Walther**

The global trade picture for 2007 looks substantially different than it did a year ago. As 2005 came to a close, most of the world's trading nations still held out hope for a successful multilateral trade agreement in the World Trade Organisation (WTO) that would yield far-reaching reforms to the international trading environment for both developed and developing countries. As 2006 draws to a close, the reality is setting in that those global trade talks may not be finalised for several years, causing the principal trading nations of the world to shift their focus to a "new generation" of bilateral and regional free trade agreements (FTAs).

A WTO agreement, far more so than regional and bilateral ones, would redress the economic distortions of agricultural subsidies, restrictive standards and systemic issues. If no WTO breakthrough is achieved by spring 2007 however, it is unlikely that a WTO agreement will be concluded until after the 2008 U.S. Presidential elections. With that in mind, the United States, the European Union, China and other countries are readying an alternative strategy of targeted regional and bilateral free trade agreements.

> "The European Union has promised to cover all areas of trade, and even reach into the investment and competition domains, in its new trade arrangements."

The United States already has 10 FTAs covering markets throughout the globe. Canada, Mexico, Chile, Australia and the Central American countries are among its principal FTA partners. Five agreements have been concluded, or are close to being concluded, in 2006. Agreements with South Korea, Malaysia, Panama and Thailand are pending. Each of these agreements cover all areas of trade, eliminating or substantially reducing trade barriers for U.S. industrial goods, agricultural goods and service sectors. While new FTA candidate countries will need to await renewed Trade Promotion Authority (TPA) in mid-2007, it is likely that the U.S. government will find a way to continue with ambitious FTA initiatives, with or without TPA authority, to ensure continuing market growth for U.S. commerce.

> "China, too, is seeking FTA agreements inside and outside of Asia."

The European Union, not wanting to be left behind, announced in October that it, too, is forging ahead with its own new generation of FTAs to help improve the competitiveness of EU companies in key enlarging markets. Its principal targets include the Association of Southeast Asian Nations (ASEAN) region—South Korea, India, Russia —and the Mercosur countries of Latin America. Although the EU's brand of FTAs until now has excluded most sensitive goods, the European Union has promised to cover all areas of trade, and even reach into the investment and competition domains, in its new trade arrangements.

China, too, is seeking FTAs inside and outside of Asia. It has already concluded FTAs with Chile and Thailand, and is now negotiating with Australia and New Zealand. Next in line are agreements with South Korea, Japan, the countries of the Southern African Customs Union, the ASEAN bloc, and possibly the European Union.

Whether a multilateral agreement is forged under the WTO, or major trading nations turn to bilateral and regional free trade agreements, U.S. and foreign businesses can best take advantage of the new trading environment by understanding the benefits and risks of these agreements for their individual industries and sectors.

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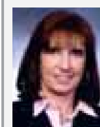

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Protecting Business Through International Arbitration

By **David Baron**

As competition for investment is increasing, businesses and countries seeking foreign or domestic investment are realising that investors follow stability. One of the best ways to create stability is to assure investors that when they enter a new market, they will be able to retain control of their profits and personnel, enforce contracts, and engage in productive activities rather than being trapped by ineffective laws or inefficient regulations. If you think your property is going to be expropriated, if you suspect the rules of the game will change arbitrarily or if you feel the system is unstable, then you are unlikely to do business in that market.

International arbitration is one of the best ways to bridge the gap between international businesses and investors because it serves as an insurance mechanism for pre-empting or resolving disputes. This is most important in emerging markets with weak or unstable institutions because arbitration essentially interposes a working system for resolving disputes.

Arbitration proceedings are invoked through written agreements which establish consent to certain rules and procedures for addressing and resolving disputes. The agreement should be in writing so that it can fall within the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention. The most attractive feature of the New York Convention is that an arbitral ruling made under it can be judicially enforced in one of the more than 135 countries that have signed the New York Convention.

To the extent that the dispute involves a commercial entity and a government or state-owned entity, the necessary arbitration agreement between the parties can exist without "privity of contract". Many countries have signed bilateral investment treaties or other similar agreements. These contain a general consent or willingness to submit disputes concerning international investments in that country to binding international arbitration. Where such international agreements are applicable, affected commercial entities can attempt to obtain similar relief through arbitration and enforce any resulting judgment through the mechanisms established by and under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).

Arbitration v Litigation

Litigation involves domestic court proceedings where one party is usually in its home territory. This can create numerous problems and difficulties (both perceived and real) for the foreign participant in terms of having to navigate the local waters and gaining equal access to the legal system. More importantly, litigation is a more formal process than arbitration. As a manifestation of the consent of the parties, arbitration is less strict, more flexible and frequently more able to meet the parties' needs.

There are several different types of arbitration. One is "*ad-hoc* arbitration", in which two parties sign an agreement that essentially creates their own mechanisms for resolving the dispute, or adapts mechanisms from other sources.

> "International arbitration is one of the ways to bridge the gap between international businesses and investors."

The second type is institutional arbitration in which parties go to an established international arbitration body and request its services to resolve the dispute. The three major international arbitration institutions are the International Chamber of Commerce (ICC), the London Court of International Arbitration and the American Arbitration Association's International Centre for Dispute Resolution. These institutions have mechanisms and rules that are already in place. Their rules establish many important procedural points, such as how the arbitrators are appointed, how they are compensated, the time-frame for the arbitration proceedings, how the arguments are to be presented and how the proceedings are to be conducted.

Ad Hoc v Institutional Arbitration

If you use the ICC, you have to pay the Chamber a sum based on the amount of money at issue in the dispute. Thus, the bigger the dispute, the more you have to pay. In addition to having to pay the fees of the arbitrators, you have to pay the administrative staff's fees and the overhead that goes into developing their mechanisms. Although *ad hoc* arbitration might be less expensive, working outside the established system has its problems. For example, if you decide to develop your own rules and choose your own arbitrators, it may be very difficult to even reach agreement with the opposing party about who should resolve the dispute and how it will be resolved.

Multinational companies and corporations and entities that do business abroad overwhelmingly prefer institutional arbitration. According to a recent study by PricewaterhouseCoopers, 76 per cent of the respondent multinational companies prefer to work with one of the major institutions, and 95 per cent will continue to do so. There are a number of possible reasons for this preference. Institutional arbitration has inherent prestige, the process is a lot more certain and institutional arbitrators are entirely neutral and not affiliated with either party involved.

International institutions also play an important role in facilitating the enforcement of an arbitral award. When parties take a decision from an established institution to a domestic court and request enforcement, judges are more likely to agree that the arbitrators gave the case their careful consideration, and therefore the court can enforce the award with confidence.

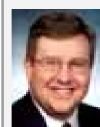
Regional Arbitration Centres v Institutional Arbitration

You can also use regional arbitration bodies to resolve a dispute. Often, the big differences between a regional arbitration centre and an institution like the ICC are going to be the identities of the arbitrators and the rules to be used. If you are working through one of the major institutions and you have a big international commercial dispute, you are likely to get an international arbitrator of some international renown who may cost more, but will have a lot of experience.

If, for example, you are using a Latin American dispute resolution centre such as the Inter-American Commercial Arbitration Commission or the Commercial Arbitration and Mediation Center for the Americas, you are likely to get well respected Latin American international jurists as arbitrators. As with all non-English-speaking countries, parties should ensure that they have qualified, in this case Spanish-speaking, counsel with experience in conducting arbitrations in the region. The rules are also going to vary slightly from some of the larger institutions. Such regional arbitration usually costs less money than international institutional arbitration. More importantly, the secretariat and the administrative personnel who are going to be working on the case and with the parties will frequently come from the same cultural background.

Common cultural background is important because it ensures that the arbitration team shares your frame of reference, allowing you to avoid the level of cross-cultural difficulty that can exist when dealing with large international institutions. That said, international institutions routinely deal with such cultural and linguistic differences. Also, while you can get closer to the problem and closer to the people by using a regional dispute centre, the trade-off can be the loss of the benefits of bigger international organisations in terms of degrees of experience, numbers of cases and history.

Depending on where it is you intend to enforce the award, it may be advantageous to use a regional dispute resolution centre with well-known arbitrators rather than an international institution. It is always good to successfully resolve a dispute through arbitration; it is even better to be able to enforce the resulting award.



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A longer version of this article will be included in a forthcoming Economic Reform Feature Service from the Center for International Private Enterprise.

Inventors Beware U.S. Export Controls

By **David Levine** and **Tomoki Tanida**

Multinational technology companies need to be aware that U.S. export controls apply to intra-company reviews of technology for patent applications.

Such companies with operations in the United States often encounter the following scenario: research and development (R&D) is conducted in the United States; the R&D results in a new invention; non-U.S. personnel must review the technology or it must be reviewed outside the United States; and patent applications for the new invention must be filed in multiple jurisdictions, including the United States.

In this scenario, the release or transfer of the technology for review by non-U.S. personnel, or review outside the United States, constitutes an "export" of the technology that may be controlled by the Export Administration Regulations (EAR) under U.S. export laws. Depending on the classification of the technology under the EAR, which is administered by the U.S. Commerce Department's Bureau of Industry and Security (BIS), a licence may be required before exporting the technology. If, based on its classification, neither the technology nor the invention is controlled under the EAR, it may be exported without a licence to most destinations and to most end-users. It is important to bear in mind, however, that U.S. laws and regulations restrict or prohibit exports to certain destinations and end-users, regardless of the classification of the items or technology.

> "Violations of the EAR may result in penalties of up to U.S.$50,000 per violation."

Notwithstanding the export classification, in order to file a patent application outside the United States for U.S.-originating technology, a foreign filing licence must first be obtained from the U.S. Patent and Trademark Office (USPTO).

Significant penalties may be imposed for violations of the EAR and USPTO export rules.

Export Licence Requirements Under the EAR

The EAR define "export" as "an actual shipment or transmission of items subject to the EAR out of the United States, or release of technology or software subject to the EAR to a foreign national in the United States". Under the EAR, BIS regulates exports of most items that have both commercial and military applications (*ie,* "dual use" items), as well as some commercial items without an obvious military use.

Export licence requirements for any particular item or technology depend on its specific technical characteristics, the destination, the end-user and the end-use. An exporter must determine whether a licence requirement applies based on the following:

- what is being exported (*ie,* how it is classified under the EAR)
- where it is going
- who will receive it
- what it will be used for.

If, based on these factors, a licence requirement applies, the exporter must apply for a licence from BIS before exporting the item or technology. For technology that is intended to be exported for the sole purpose of filing a patent application outside the United States, BIS has delegated export licensing authority to the USPTO. In this situation, the exporter does not need a separate licence from BIS under the EAR.

Violations of the EAR may result in penalties of up to U.S.$50,000 per violation.

Foreign Patent Filing Licences

For inventions made, even partially, in the United States, a foreign filing licence must be obtained from the USPTO before filing a patent application in a foreign country. This is regardless of whether an export licence requirement applies to the technology under the EAR. For technology controlled under the EAR, a foreign filing licence from the USPTO also serves as an export licence. This allows non-U.S. persons in the United States and anyone outside the United States to review the invention for purposes of preparing a non-U.S. patent application. No foreign filing licence is required for inventions made outside the United States, even if invented by a U.S. person.

A filer need not apply for a patent in the United States in order to obtain a foreign filing licence from the USPTO. A simple request can instead be filed with the Licensing and Review division of USPTO, together with a U.S.$200 filing fee. A foreign filing licence request does not constitute a "filing" in the United States, and requires merely a description in English of what the invention entails. Nevertheless, a foreign filing licence can also be obtained with a U.S. patent application, and one is issued automatically six months after the application for a U.S. patent is lodged.

If a patent application is filed in a foreign country without first procuring the foreign filing licence, a patent on the same subject matter will be invalid in the United States. Willful foreign filings lodged without first obtaining a foreign filing licence could result in a penalty of up to U.S.$10,000 or imprisonment of up to two years. A foreign filing licence can be obtained retroactively by petition, provided that the illegal foreign filing occurred through error and without intent to deceive.

> "If a patent application is filed in a foreign country without first procuring the foreign filing licence, a patent on the same subject matter will be invalid in the United States."

Practical Recommendations

Multinationals, particularly non-U.S.-based companies, that wish to review U.S.-made inventions for the purpose of filing patent applications outside the United States should first obtain a foreign filing licence from the USPTO. The process is relatively inexpensive and avoids the somewhat more complicated process of obtaining a licence from BIS under the EAR. It is also quick; the USPTO typically issues foreign filing licences within three days of requests.

Non-U.S.-based companies must understand, however, that a USPTO foreign filing licence does not authorise non-U.S. nationals to review a U.S.-made invention for purposes of filing a U.S. patent application. For technology controlled under the EAR, such review would first require an export licence from BIS.

In order also to preserve the earliest filing date for U.S. patent applications, in addition to requesting a foreign filing licence, companies should also consider filing a provisional application for a patent with the USPTO. This is a preliminary application that permits an applicant to secure an early filing date for an invention. The provisional application must include a specification describing the invention together with necessary drawings and the U.S.$200 filing fee. The provisional patent application is abandoned 12 months after its filing date. To take advantage of the early filing date, a full patent application must be filed within 12 months of the filing date of the provisional application. By concurrently requesting a foreign filing license and filing a provisional patent application with the USPTO, a company can review the technology, apply for the foreign patent, and still preserve a timely U.S. patent filing date.

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Proposed U.S. Congressional Action Against China

By Michael House

Of the many international subjects that capture the attention of the U.S. Congress each year, none is more pervasive than U.S. trade relations with China. In recent years, the elected members of the U.S. Senate and House of Representatives have introduced dozens of new proposals to counteract what they perceive as continued and growing unfair trade practices by China. If the most recent session is any guide, Congress in 2007 will be no exception. By the end of December 2006, members of Congress will have introduced no fewer than 109 separate pieces of legislation that target China, either directly or indirectly. Many, if not most, of these proposals will find their way onto the 2007 legislative calendar.

The variety of the topics contained in these legislative proposals is diverse. Some members, for example, have proposed legislation that would entirely withdraw normal trade relations (NTR) status from China, effectively raising tariffs to prohibitive levels on a wide variety of imported China-originating products. Other members have focused on China's mixed record of intellectual property compliance. There is one proposal that would express the feeling of the U.S. Senate that the U.S. government should file a World Trade Organisation (WTO) case against China on this issue.

In most cases, the various pieces of legislation proposed in Congress have remained just that—proposals—with no binding effect having never been passed and enacted into law. Members of Congress must now re-introduce any unenacted bills that they wish to be considered in the new Congress that will convene in January 2007, following the mid-term elections that were held in November 2006.

Among the many China-targeted legislative proposals that are likely to be resurrected in 2007, there are a handful that have a realistic chance of being enacted. Two in particular are worth noting, as they are likely to define the debate on China trade in the 2007 Congress.

Exchange Rates and "Currency Manipulation"

The U.S. dollar-Chinese yuan exchange rate has been the focus for many members of Congress who strongly believe China has manipulated its currency to maintain a relatively weak valuation against the U.S. dollar. This, of course, provides an advantage to Chinese exports by ensuring that their prices, as expressed in U.S. dollars, remain competitive in the U.S. market. Driving the concern is the U.S.-China trade deficit, which has grown sharply in recent years. The trade deficit with China in 2006 was running at a level 13.5 per cent above that in 2005, when it hit an annual U.S.$202 billion, the highest ever recorded with a single country.

To counter this deficit and the perceived "manipulation" of currency values, two prominent U.S. senators, Republican Senator Lindsey Graham and Democratic Senator Charles Schumer, introduced proposed legislation in the most recent congressional session that would have imposed a flat 27.5 per cent duty on imports of all Chinese goods unless and until China revalues its currency. This controversial proposal, which was opposed by President Bush, drew the support of more than two-thirds of the U.S. Senate.

Despite this broad support, the Bush Administration persuaded Congress in late 2006 to hold off enacting such draconian measures until after China has had a chance to take measures to revamp its currency system and the U.S. Treasury Department has had an opportunity to review more carefully those new currency provisions. The Administration also cited the concern that an across-the-board tariff on China could violate U.S. obligations under WTO agreements. By the end of 2006, it was clear that the Schumer-Graham bill would not advance, and the two sponsors agreed to postpone any vote on the measure. Their agreement was grudging, however, and they made it clear that they remained impatient with China's progress.

In 2007, senators Schumer and Graham are likely to intensify their review of the pace of yuan-dollar valuation and move to introduce similar draconian tariff measures if the figures do not change appreciably. With a demonstrated record of support by a majority of senators for such a measure, and with a changing political landscape as a result of the November 2006 congressional elections, this initiative may find a receptive audience in Congress.

Comprehensive Trade Measures on China

One influential U.S. senator who has opposed the Schumer-Graham bill is Republican Senator Charles Grassley. Senator Grassley is chairman of the Senate Finance Committee, which is responsible for the final approval of all trade-related legislation before it reaches the entire Senate for consideration. Senator Grassley has said that, instead of an arbitrary and draconian flat tariff on Chinese imports (which he also views as difficult to defend under WTO rules), he favours a more comprehensive approach. This would include revamping the way that the United States approaches trade as well as currency issues with China.

As a result, Senator Grassley and another key member of Congress, Senator Max Baucus, support a comprehensive legislative proposal that would overhaul U.S. policy on foreign currency exchange rates. The intention is that it will strengthen U.S. trade enforcement efforts in a variety of areas, particularly with regard to China. Although the bill would be applied to U.S. policies toward all of its trading partners, the Grassley proposal is widely viewed as targeting China specifically.

Grassley's bill would overhaul U.S. policy on foreign exchange rates by repealing the 1988 law that requires the Treasury Department to determine whether foreign countries are manipulating their currencies. Instead, the Treasury Department would be required to list those countries with "fundamentally misaligned" currencies that have "a material adverse impact" on the U.S. economy. The bill would provide for punitive measures in cases where a country with a "misaligned currency" refuses to negotiate or, after negotiations commence, refuses to "adopt appropriate policies to eliminate" the misalignment. In addition to denial of multilateral financing, the currency "misalignment" could be the subject of a countervailing duty (subsidy) action under U.S. trade remedies laws, which could result in additional tariffs on goods exported from the target country.

Senator Grassley views his proposal as more effective because it does not use the pejorative term "currency manipulator", and it is more defensible under WTO rules. The legislation defines "fundamental misalignment" as "a material sustained disparity between the observed levels of an effective exchange rate for a currency and the corresponding levels of an effective exchange rate . . . that would be consistent with fundamental macroeconomic conditions based on a generally accepted economic rationale".

> "The Grassley proposal is widely viewed as targeting China specifically."

Equally important, Senator Grassley's proposal would strengthen U.S. trade enforcement, particularly toward China. The legislation would elevate the Office of the U.S. Trade Representative's general counsel to a senate-approved position, and specify that a "principal function" of the general counsel is to enforce U.S. trading partners' compliance with trade agreements. The bill would also set up a Trade Enforcement Working Group, composed of senior officials from various Cabinet departments as chosen by the U.S. Trade Representative; impose a new deadline for action following the USTR's completion of the annual National Trade Estimate Report on Foreign Trade Barriers; and establish a chief enforcement officer at USTR, which would be a Senate-confirmed position and require the identification of priority foreign country trade practices.

Given the stated positions of members of Congress on trade with China over the last two years, some form of legislation adopting the currency and trade enforcement provisions of Senators Grassley, Graham and Schumer's proposals will be the focus of congressional debate throughout the 2007 congressional session.

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New Policy Overturns Traditional EU Anti-Dumping Practice

By Michal Cieplinski and Elena Kostadinova

"… I will undertake a review of the way trade defence instruments operate in the face of globalisation… These are important and necessary instruments. Nevertheless, we have to ensure that such rules are adapted to the complexity of global markets. And to the changing patterns of trade and production, where manufacturers in the EU may compete with European distributors who have outsourced production, and where consumers and other manufacturers expect the benefits of wider choice and lower prices".

These are the words which Peter Mandelson, EU Commissioner for Trade, used on 4 May 2006 to announce to the world his change in trade defence policy. The statement came barely six weeks after he had defied established legal practice by persuading his fellow Commissioners to start "phasing-in" the imposition of provisional anti-dumping duties on imports of leather-upper shoes from China (the shoes case). Several months after this speech, he also managed to persuade the 25 EU Member States to agree to definitive anti-dumping duties on leather-upper shoes with effect from 7 October 2006.

The shoes case has forced businesses to re-examine their approach to trade defence measures in the European Union. The Commission has departed from existing practices based on strict application of the Anti-Dumping Regulation and dived into political considerations and compromise in the search for a well-balanced solution aimed at satisfying all the parties involved. It seems, however, that no party fully embraces the Commission's proposals.

Investigation

The initiation of the shoes case in July 2005 following a complaint by the European Confederation of the Footwear Industry (CEC) was already unusual. While complaints are always treated in confidence, in the shoes case, the Commission took the unprecedented step of dispatching several officials to both China and Vietnam to provide technical assistance to the targeted companies in advance of the opening of the investigation.

The case provoked huge interest due to the wide variety of economic operators involved. Of the 163 companies

in China and 86 in Vietnam that came forward to take part in the investigation, the Commission investigated just 13 from China and eight from Vietnam, accounting for around 25 and 22 per cent Chinese and Vietnamese exports of shoes to the European Union respectively. Unlike any other anti-dumping investigation, the Commission took the Chinese Government's request into consideration and increased the number of Chinese and Vietnamese companies sampled.

The Commission, in an unprecedented attempt to find a solution acceptable to large multinational producers of footwear, also revised the product scope of the investigation. Initially, the case referred to a specific category of shoes—footwear with leather uppers, excluding sports footwear, slippers and other indoor footwear, and footwear with a protective toecap. The principal victory in the case was won by the producers of branded "trainers", defined as special technology athletic footwear (STAF), with production facilities in China and Vietnam. Faced with the daunting possibility that a majority of their product lines might be subject to anti-dumping duties, these companies launched an unparalleled lobbying campaign. The Commission surrendered to the pressure of the STAF producers and excluded STAF footwear from the scope of the investigation. In fact, the Commission even enlarged the definition of STAF to include all special technology athletic footwear with a minimum cost, insurance and freight (CIF) price of €7.50 instead of the €9 threshold used in earlier trade cases.

> "The shoes case has forced businesses to re-examine their approach to trade defence measures in the European Union."

Since China and Vietnam are not market economy countries, the Commission had to establish whether the co-operating companies nevertheless operate under market economy conditions. For companies granted market economy status (MES) the question as to whether they were practising dumping is determined by reference to their own costs and prices. If the Commission rejects MES the fair market value is calculated for analysis purposes on the basis of data from an "analogue" country—a market-economy third country. After the investigation of the sampled companies, the Commission rejected all 249 MES applications and calculated the dumping margins based on fair market value in Brazil. This refusal led to an uproar among exporters and a threat of WTO action by the Chinese Government. As a result, the Commission revised its decision and granted MES to just one company, setting a new precedent. By refusing all but one of the MES applications, the Commission paved the way for adoption of a single duty for all Vietnamese and all but one Chinese exporters.

> "The facts of the shoes case show a clear change in direction in the interpretation and implementation of the Anti-Dumping Regulation."

Compromise

The change in trade defence policy was clearly demonstrated at the preliminary determination stage by the decision to phase-in the provisional duties over six months. The level of duties started at 4.8 per cent for China and 4.2 per cent for Vietnam, increasing to 19.4 per cent for China and 16.8 per cent for Vietnam. The decision was taken in order to give the Community footwear industry time to expand capacity and the Community importers time to adapt to the duties due to the seasonal and fashion-driven nature of the product.

After months of deliberations and various political compromises, the Commission and pro-duty lobby managed to convince the majority of the EU Member States to vote in favour of the anti-dumping duties. The Commission, having the necessary support of the Member States, imposed definitive anti-dumping duties at the rate of 10 per cent for all Vietnamese exporters and 16.5 per cent for all Chinese exporters (except the exporter who qualified for MES for whom the rate was 9.7 per cent). The most visible part of the political compromise is the fact that the Commission was forced to impose the anti-dumping duties for a period of only two years, instead of five years as required by the EU Anti-Dumping Regulation. These new duties, which are well below the level hoped for by the EU domestic industry, will affect 11 per cent of the 2.5 billion shoes purchased every year in Europe. This amounts to approximately 174 million pairs from China and 103 million from Vietnam.

The facts of the shoes case show a clear change in direction in the interpretation and implementation of the Anti-Dumping Regulation. The ease with which a European industry used to obtain complete protection against dumping practices is called into question. European producers who have outsourced their production to low-cost countries have realised that their interests may be just as important as those of their colleagues who still produce in the European Union. There is a clear indication that political factors are beginning to infiltrate the Commission's thinking at the expense of the rule of law established in the Anti-Dumping Regulation.

As for future anti-dumping cases, the shoes case provides a precedent for increased politicisation of the decision-making process. This may be desirable in some respects, because, if properly used, it could lead to more imaginative solutions for difficult trade problems. Unfortunately, it may also have the undesirable effect of introducing greater uncertainty for market operators. It seems that the level of compromise needed to take unprecedented action may not be worth overturning accepted practice after all.

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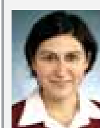

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National Champions in the EU Single Market—Spain v the European Commission in the Bids for ENDESA

By **Ian Rose** and **Helen Bignall**

"The Commission will not hesitate to continue enforcing the legal instruments at its disposal should a Member State unjustifiably oppose free movement of capital or mergers of a Community dimension between companies in different Member States." (Neelie Kroes, European Commissioner for Competition, 12 June 2006.)

Businesses looking to expand cross-border within the European Union should have confidence in the hard line that the European Commission (the Commission) is taking against the promotion by some individual EU Member States of "national champions".

The free-movement principles of the EU Single Market provide a right of access for businesses to the European Union of 460 million people. The free movement of goods and services is partly maintained by the Commission's power to regulate major cross-border mergers and to prohibit them when they are incompatible with the Single Market. EU merger control rules provide for exclusive (one-stop shop) notification to the Commission. However, only the largest mergers, by reference to the revenues of the companies concerned, are assessed. If each of the companies concerned achieves more than two-thirds of its revenues within one and the same Member State, then the Commission loses its exclusive competence (the two-thirds rule).

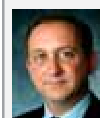
In recent months, the Commission has been frustrated by the two-thirds rule, which has rendered it powerless to intervene in all of the bids for ENDESA. In this case, there were two bids for ENDESA: one from Gas Natural SDG S.A., the Spanish incumbent natural gas operator, and one from E.ON AG, the Germany-based utility company. Due to the two-thirds rule, only the E.ON bid fell under the Commission's jurisdiction. The Gas Natural bid fell under Spanish national competence.

Following the Spanish Government's approval of the Gas Natural takeover, Spain amended its law by Royal Decree so that the Spanish regulator was empowered also to examine E.ON's bid, which had already been cleared by the Commission. In May, the Commission started formal proceedings against Spain on the basis that the Royal Decree restricted the free movement of capital and the right of establishment. The Commission subsequently asked Spain to modify the Decree after the Spanish regulator subjected E.ON's proposed acquisition to 19 conditions, 18 of which the Commission ruled were in breach of the EU merger control rules.

Spain ratified its decision, despite being legally bound by the Commission's ruling. This could have led the Commission to refer the matter to the European Court of Justice. However, the Spanish Industry Ministry has since overturned some of the conditions imposed by the Spanish regulator. In particular, E.ON will no longer have to divest around 30 per cent of ENDESA's assets. E.ON has accepted the revised conditions and the European Commission is continuing its review in light of the updated proposals.

The Commission's interest in this case was, to some extent, fuelled by the increase in cross-border mergers in the European Union, particularly in the gas and electricity sectors.

It is rare that a Member State would challenge the Commission's role as exclusive merger control authority. This case should give confidence to companies that the Commission will act strongly against any attempt by EU Member States to hinder the free movement of goods and services through the promotion of national champions in breach of the EU merger control rules.



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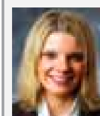

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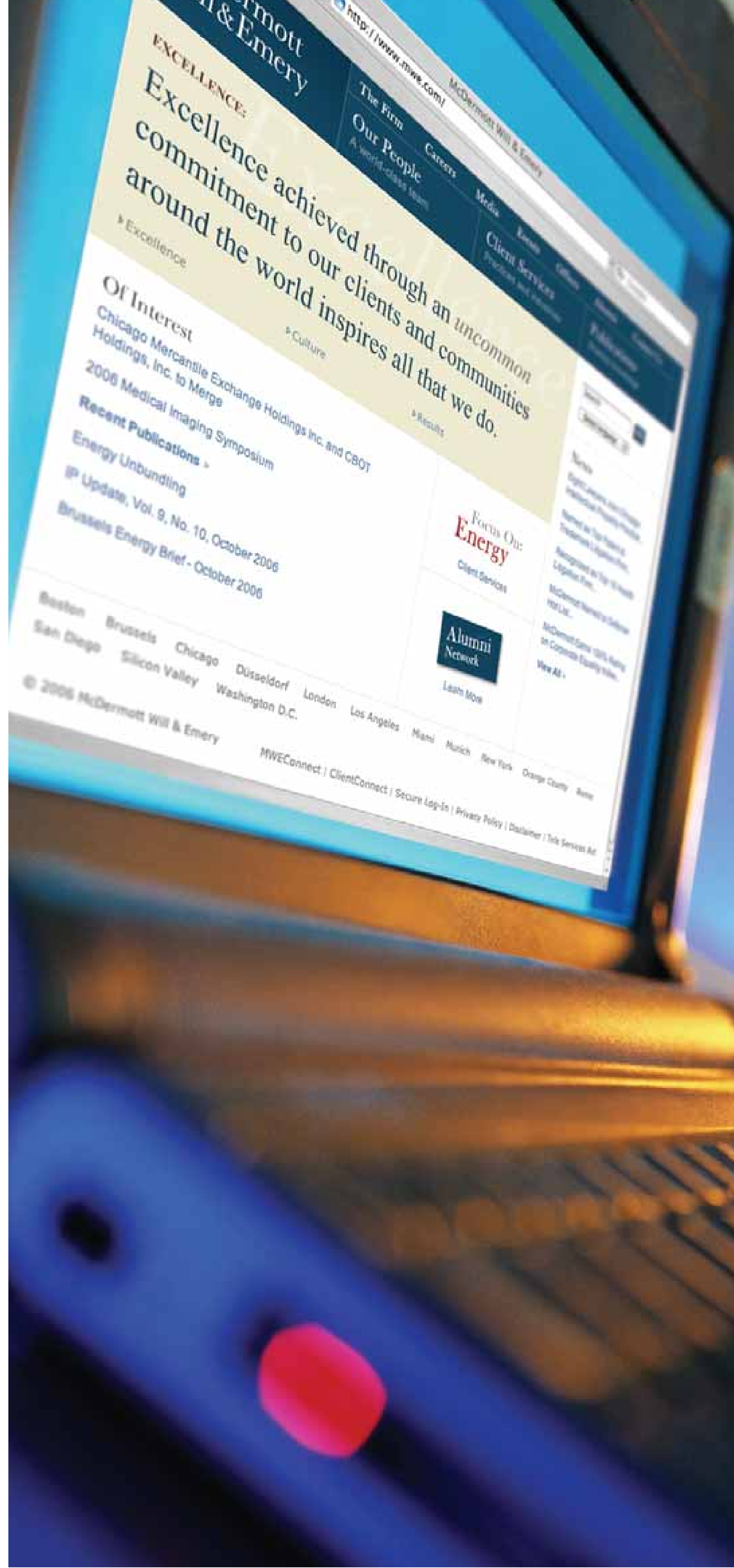

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