BUSINESS LAW INTERNATIONAL

VOL 16 NO 3 SEPTEMBER 2015

Business Law International

Vol 16 No 3 pp 183–274 ISSN 1467 632X **September 2015**

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Business Law International

Published by the Legal Practice Division of the International Bar Association

Business Law International

Business Law International is a journal of the International Bar Association Legal Practice Division.
It is published three times a year.

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Free to members of the Legal Practice Division.
Annual subscription for non-members, including index:
2015 prices:
£235 ($353) full year; £92 ($138) single issue.
Please order from the International Bar Association at **subscriptions@int-bar.org**.

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www.ibanet.org

Postal Information
This journal is published three times a year.
Postmaster: send corrections to:
member@int-bar.org

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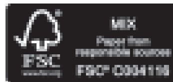
Printed by Pensord.



Articles appearing in this journal are indexed in:

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Business Law International

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Business Law International, published by the Legal Practice Division of the IBA, is the leading law journal devoted to issues of relevance to the international commercial, legal and academic community.

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BLI Speedread

A brief overview of the articles in the September 2015 issue of *Business Law International*

The Impact of New Transatlantic Trade Agreements on Commercial and Investment Transactions

Neil Campbell, Jonathan O'Hara and Timothy Cullen

The EU and Canada have developed a broad-based bilateral trade and investment agreement which will almost eliminate tariffs, reduce some important barriers to trade in services, extend government procurement rules to the sub-federal level, encourage regulatory coordination and establish important protections for foreign investors. These changes are likely to create substantial opportunities for suppliers and investors in both jurisdictions. In addition, they will create a benchmark for a much larger EU agreement. This article explores the implications of several of the most important EU-Canada provisions for international firms and their advisers. It also discusses the current status and potential scope of an EU-US agreement, considering the hurdles that may be encountered when attempting to negotiate tarrif reductions in areas where the US and EU have longstanding differences. The article will consider the three main pillars of negotiation for a US-EU deal: market access, regulatory cooperation and rules.

Fiscal Transparency – International Business Structures and Issues

Jennifer Wheater and David Sussman

The way in which an entity is treated for tax purposes has a significant impact on the efficiency or otherwise of an overall structure. The concept of fiscal transparency can be extremely beneficial in limiting tax exposure, but it brings with it other complexities which need to be considered in context. Increasing globalisation has added to the issues facing transparent vehicles. The absence of a universal test of transparency can result in inconsistent treatment between jurisdictions with undesirable results. Furthermore, recent Base Erosion and Profit Shifting (BEPS) and information sharing initiatives have already created some confusion in terms of the treatment of partnerships, and other transparent entities may well face similar difficulties in the future.

Regulation of Parallel Import in the Eurasian Economic Union

Alexander Bondar

This article is devoted to the interpretation of the principle of the exhaustion of rights that raises the phenomenon of parallel import. The article discusses recent trends in legalisation of parallel import within the framework of the Treaty on the Eurasian Economic Union that entered into force on 1 January 2015. The article also analyses the recent court practice in the Russian Federation, the Republic of Belarus and Kazakhstan in relation to the protection of the exclusive rights of right holders and prohibition of parallel import.

Data Security and the Legal Profession: Risks, Unique Challenges and Practical Considerations

Anurag Bana and David Hertzberg

Data security is an increasingly prominent and important area of risk for the global legal profession. Lawyers in all jurisdictions and practice settings need to be more proactive in protecting electronically stored information. The intersection between data security and lawyers' ethical obligations of confidentiality, competence and protection of property in their trust creates unique challenges for the legal profession. Leadership needs to come from management, but the nature and scale of the risk and the resource-intensive nature of data security call for sector-orientated assistance. International and domestic bar associations and law societies need to raise awareness and provide education, training and other resources to assist lawyers to address data security risk.

Case note: *Lawson v Serco* and recent developments in the territorial scope of UK employment law

Sarah Ozanne

The territorial scope of UK employment law is a complicated and developing legal area. In the absence of express statutory provisions it has been left to case law to set out and develop the necessary parameters. This article reviews the background to this legal area, including the pivotal case of *Lawson v Serco* from which general legal principles in this area emerged, and looks at recent cases where the outcome was not what might initially have been expected.

The Impact of New Transatlantic Trade Agreements on Commercial and Investment Transactions

Neil Campbell, Jonathan O'Hara and Timothy Cullen[1]

Overview

The European Union (EU) and Canada have developed a broad-based bilateral trade and investment agreement that will almost eliminate tariffs, reduce some important barriers to trade in services, extend government procurement rules to the sub-federal level, encourage regulatory coordination and establish important protections for foreign investors. These changes are likely to create substantial opportunities for suppliers and investors in both jurisdictions. In addition, they will create a benchmark for a much larger EU agreement. This article explores the implications of several of the most important EU-Canada provisions for international firms and their advisers. It also discusses the current status and potential scope of an EU-United States agreement.

Evolving transatlantic trade relationships

The idea of a transatlantic economic community was floated when the North Atlantic Treaty was signed in 1949,[2] and a Transatlantic Free Trade

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1 Neil Campbell is the Co-Chair of Competition and International Trade at McMillan in Toronto, Canada. Jonathan O'Hara and Timothy Cullen are associates in the Trade and Advocacy groups in McMillan Ottawa office. The assistance of Shauna Cant, a summer student in McMillan's Ottawa office, is gratefully acknowledged.

2 Colin Robertson, 'Canada-EU trade deal close to completion. Now the hard work begins' *The Globe and Mail* (16 September 2014) www.theglobeandmail.com.

Agreement (TAFTA) that would complement the North American Free Trade Agreement (NAFTA)[3] has occasionally been discussed since the mid 1990s.[4] Although there was insufficient appetite to pursue such an agreement historically, a number of factors have contributed to renewed interest in transatlantic trade liberalisation in recent years:

- Stalled multilateral negotiations – during the Uruguay Round, and for a considerable portion of the Doha Development Round, initiatives in the GATT/WTO made transatlantic agreements a relatively low priority. Freer trade between North America and Europe seemed probable simply as part of global trade liberalisation. However, with the collapse of the Doha Round negotiations in July 2008, policy-makers and private stakeholders shifted their focus towards bilateral and regional trade agreements.[5]
- Stagnant economic growth – the major economies on both sides of the Atlantic have struggled with slow economic growth in recent years. From 2007 to 2013 the US economy only grew by an annual average of one per cent, while the EU's economy grew even more slowly, averaging 0.4 per cent per year.[6] Transatlantic trade agreements are seen as a mechanism to 're-invigorate economic growth' by 'realizing the untapped potential of transatlantic economic cooperation'.[7]
- Increasing competitive pressure from growing economies – rapid growth in emerging markets has increased global competition and productivity, driving substantial change in the world economy and trade flows.[8] Recovery from the 2008 financial crisis has been much stronger in the developing countries than in developed countries.[9] Led by the

3 North American Free Trade Agreement, Canada, United States and Mexico (entered into force 1 January 1994).

4 Shayerah Ilias Akhtar and Vivian C Jones, 'Transatlantic Trade and Investment Partnership (TTIP) Negotiations' Congressional Research Service: R443387 (4 February 2014) www.fas.org/sgp/crs/row/R43387.pdf ('Congressional Research Service'), 2.

5 *Ibid* 74–75; Erica Alini, '10 things you need to know about CETA' *MacLean's* (18 October 2013) www.macleans.ca (Alini article).

6 Congressional Research Service, see n 3 above, at 74–75; World Bank, 'GDP Growth (annual %)' (2015) http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/EU-US?display=graph.

7 Council of the European Union, 'EU-US Summit – Joint Statement' (28 November 2011) www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/126389.pdf; see also BBC, 'TTIP: The EU-US trade deal explained' (18 December 2014) www.bbc.co.uk/news/uk-politics-30493297.

8 'When giants slow down' *The Economist* (25 July 2013) www.economist.com/news/briefing/21582257-most-dramatic-and-disruptive-period-emerging-market-growth-world-has-ever-seen.

9 United Nations, 'World Economic Situation and Prospects 2012: Global Economic Outlook' (2011) www.un.org/en/development/desa/policy/wesp/wesp_current/2012wesp_prerel.pdf; Congressional Research Service, see n 3 above, at 2–3.

success of the BRIC jurisdictions (Brazil, Russia, India and China),[10] the macroeconomic performance of emerging economies is being translated into increased geopolitical heft on the world stage. Transatlantic trade liberalisation is one of the ways that North America and Western Europe can improve their efficiency and competitiveness in response to this shifting of economic power.[11]

North America and the EU collectively account for nearly half of both the global GDP[12] and total world trade.[13] They also account for the vast majority of transatlantic trade. The remainder of this article therefore focuses on efforts to develop or expand free trade agreements between the EU and the US, Canada and to a lesser extent Mexico.[14]

The EU

The fundamental foundations of the EU include internal economic integration (the 'single market' objective) and enhanced external trade relationships (operating as a formal customs union). Since various regulatory areas significantly affect trade and investment flows, much of 'European law' has developed to support these economic objectives.

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10 The share of global trade from BRIC countries has grown from 4.9 per cent in 1993 to 15.4 per cent in 2013; see UNCTAD Statistics, 'Goods and Services (BPM5): Exports and imports of goods and services, annual' data series online: http://unctadstat.unctad.org.

11 Antonio Fatas and Ilian Mihov, 'Global economic balance shifting east' *The Globe and Mail* (12 September 2012) www.theglobeandmail.com/report-on-business/economy/economy-lab/global-economic-balance-shifting-east/article544577/.

12 Gross domestic product by purchasing power parity in current international dollars. GDP data are based on 2014 International Monetary Fund (IMF) data unless otherwise stated.

13 UNCTAD Statistics, 'Goods and Services (BPM6): Exports and imports of goods and services, annual' data series online: http://unctadstat.unctad.org. By comparison, China currently has a global GDP share of 13 per cent and accounts for ten per cent of world trade.

14 There is relatively modest trade across the Atlantic involving Africa and the Americas. Transatlantic trade flows in and out of non-EU countries, the Middle East or South America are also modest (see, eg, the list of top US trading partners in 2014: US Department of Commerce, 'Top U.S. Trade Partners' (2014) www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_003364.pdf; and the list of top EU trading partners in 2014: European Commission, 'Client and Supplier Countries of the EU 28 in Merchandise Trade' (2014) http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122530.pdf.

Collectively, the EU has a population of over 500 million[15] and a GDP of US$18.5tn, representing 17 per cent of world GDP.[16] It accounts for 33 per cent of world trade[17] and 17 per cent of global foreign direct investment (FDI) flows.[18]

Given the geographical position of the EU, as well as the diversity of its membership, it has a well-diversified set of trading partners.[19] Collectively, North America accounted for 18 per cent of the EU's trade in goods in 2014.[20] The US,[21] Canada and Mexico are the EU's 1st, 12th and 15th largest trading partners, respectively.

The EU and Mexico have a bilateral free trade agreement that came into force in 2000.[22] The agreement covers trade in goods and services, as well as public procurement, market access, competition, intellectual property and investment.[23] From an EU perspective, building out bilateral trade

15 World Bank, 'Population, Total' for European Union (2013) http://data.worldbank.org/region/EUU, 2013 value.

16 IMF, 'World Economic Outlook Database April 2015' (14 April 2015) www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx, 2014 value.

17 UNCTAD Statistics, 'Goods and Services (BPM6): Exports and imports of goods and services, annual' data series online: http://unctadstat.unctad.org, 2014 values.

18 UNCTAD Statistics, 'Inward and outwards foreign direct investment stock flows, annual, 1970–2013' data series online: http://unctadstat.unctad.org, 2013 values.

19 European Commission (DG Trade), 'Statistical Pocket Guide' (May 2014) http://trade.ec.europa.eu/doclib/docs/2013/may/tradoc_151348.pdf, at p 70.

20 European Commission (DG Trade), 'Client and Supplier Countries of the EU 28 in Merchandise Trade' (13 April 2015) http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122530.pdf, at p 1.

21 The US accounts for 14 per cent of the EU's trade in goods, and the EU accounts for 18 per cent of the US's trade in goods: European Commission (DG Trade), 'Statistical Pocket Guide' (May 2014) http://trade.ec.europa.eu/doclib/docs/2013/may/tradoc_151348.pdf, at p 70; United States Census Bureau, 'Foreign Trade' (accessed 4 June 2015) www.census.gov/foreign-trade/statistics/country/index.html; Trade in Goods by Country for the EU.

22 Decision No 2/2000 of the EC-Mexico Joint Council (23 March 2000) Decision No 2/2002 at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2000.157.01.0006.01.ENG; and Decision No 2/2001 of the EU-Mexico Joint Council (27 February 2001) Decision No 2/2001 at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2001.070.01.0007.01.ENG.

23 European Commission, 'Countries and Regions: Mexico' (22 April 2014) http://ec.europa.eu/trade/policy/countries-and-regions/countries/mexico.

agreements with other North (and South[24]) American jurisdictions has emerged as a natural strategic step after the failure of the Doha Round.

The EU concluded a Comprehensive Economic and Trade Agreement (CETA) with Canada in August 2014, which provides for significant investment as well as trade liberalisation (see detailed discussion below). The EU was Canada's second-largest trading partner in 2013, accounting for nine per cent of Canada's trade in goods,[25] and 29 per cent of FDI into Canada,[26] while Canada represents 1.7 per cent of the EU's total trade in goods[27] and 1.3 per cent of its inbound FDI.[28] CETA is therefore an important agreement in its own right, although it may prove to be even more important as a trailblazer for the EU's attempt to negotiate a massive Transatlantic Trade and Investment Partnership (TTIP) with the US (see further discussion below). The EU and Mexico have also recently announced their intention to update their bilateral agreement. The stated goal is to 'make the modernized EU-Mexico trade agreement comparable to our deal with Canada and to what TTIP will become'.[29] Given various advances in the CETA, including the cumulative rules of origin, completion of the TTIP and enhancement of the EU-Mexico agreement could collectively contribute to a powerful EU-NAFTA trading bloc based on parallel bilateral trade and investment agreements.

24 The EU does not have a free trade agreement with Brazil, which is its primary trading partner in South America. The EU is pursuing a free trade agreement with the Mercosur regional association, which includes Brazil, but progress has been slow. (Negotiations started in 1999, were suspended in 2004, re-launched in 2010 and remain at the early stages.) The EU has a number of other bilateral trade agreements with South American jurisdictions: Ecuador (published February 2015, not yet ratified); Colombia and Peru (signed July 2012); Central America regional association (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama; signed June 2012); CARIFORUM (entered into force in 2008); and Chile (entered into force in 2005): see European Commission (Enterprise and Industry), 'Free Trade Agreements' (3 February 2014) http://ec.europa.eu/enterprise/policies/international/facilitating-trade/free-trade/index_en.htm.

25 European Commission (DG Trade), 'European Union, Trade in Goods with Canada' (10 April 2015) http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113363.pdf, at p 9.

26 Department of Foreign Affairs, Trade and Development Canada, 'Foreign Direct Investment in Canada – Inwards Stocks', 2014 values www.international.gc.ca/economist-economiste/assets/pdfs/Data/investments-investissements/FDI_by_Country/FDIC_stocks_by_Country-ENG.pdf accessed 15 June 2015.

27 European Commission (DG Trade), 'Client and Supplier Countries of the EU 28 in Merchandise Trade' (13 April 2015) http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122532.pdf, at p 1.

28 European Commission, Eurostat database, 'EU direct investments – main indicators (bop_fdi_main)' data series online: http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=bop_fdi_main&lang=en, 2012 values.

29 European Commission (Press Release), 'Commissioner will Upgrade EU-Mexico Free Trade Agreement' (11 May 2015) http://europa.eu/rapid/press-release_MEX-15-4959_en.htm.

North America

A less ambitious but nonetheless significant approach to trade liberalisation has occurred in North America. NAFTA is not a customs union and is not premised on creating a fully integrated market between the US, Canada and Mexico. However, it was a state-of-the-art, highly liberalising regional trade agreement when it entered into force in 1994. NAFTA focused on reductions of tariffs and other trade barriers, as well as liberalising some aspects of trade in services, with a view to allowing firms across a wide range of sectors to supply more efficiently a market that has grown to 470 million people in 2013.[30]

North America's total GDP of US$21.2tn represents approximately 20 per cent of the world's GDP. It accounts for 15 per cent of total world trade[31] and 24 per cent of global FDI flows.[32]

The three NAFTA jurisdictions have significantly different economic characteristics. The US is the dominant economy, representing over 82 per cent of the NAFTA GDP. Canada is a mature, resource-rich economy with a small population. Mexico is at an earlier stage of economic development and has significantly lower average wage rates, but has been growing faster than the US and Canadian economies,[33] and has engaged in significant regulatory modernisation. All three jurisdictions have recognised the attractiveness of the EU as a potential partner for trade and investment expansion after the failure of the Doha Round.

For Canada, the incentive to pursue a broad trade and investment agreement with the EU was in large part based on a recognition that it was strategically risky to have 66 per cent of its trade in goods,[34] the bulk of its trade in services and 46 per cent of its investment flows tied to the US.[35] In addition, Canada was originally left out of the major initiative to develop

30 The World Bank, 'Data: Population, Total' http://data.worldbank.org/indicator/SP.POP.TOTL accessed 4 June 2015.

31 UNCTAD Statistics, 'Goods and Services (BPM6): Exports and imports of goods and services, annual' data series online: http://unctadstat.unctad.org, 2014 values.

32 UNCTAD Statistics, 'Inward and outward foreign direct investment stock flows, annual, 1970–2013' data series online: http://unctadstat.unctad.org, 2013 values.

33 Based on GDP based on purchasing-power-parity valuations from 2005 to 2014: International Monetary Fund, 'World Economic Outlook Database' (2005–2014) www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx.

34 Industry Canada, 'Trade Data Online (TDO)' (last updated 13 August 2013) www.ic.gc.ca/eic/site/tdo-dcd.nsf/eng/Home.

35 Statistics Canada, 'Canadian Direct Investment Abroad (Stocks)' (April 2015) www.international.gc.ca/economist-economiste/assets/pdfs/Data/investments-investissements/FDI_by_Country/CDIA_stocks_by_Country-ENG.pdf.

the Trans-Pacific Partnership (TPP)[36] and Canadian firms in various sectors were placed at a significant disadvantage relative to US competitors when the Canada-Korea FTA lagged behind the US-Korea FTA by almost three years.[37] As a result, CETA emerged as a major strategic priority for Canada to diversify its trade investment flows as well as to avoid falling behind the US on transatlantic trade.[38] Most-favoured-nation (MFN) provisions ensure that, if the TTIP is completed and contains more beneficial terms than the CETA, Canada will get the same improved treatment as the US in areas such as investment and trade in financial and other services.[39]

Canada-EU CETA

CETA was concluded on 26 September 2014 during the EU-Canada Summit in Ottawa after more than five years of negotiations. The draft text requires legal scrubbing and translation into all 24 EU languages, followed by

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36 Canada eventually persuaded the US and other TPP jurisdictions to let it join the negotiations in 2012: PMO, 'PM welcomes all-member support for entry into trans-pacific partnership' (19 June 2012) www.pm.gc.ca/eng/node/21865. However, it is under substantial pressure from Australia, New Zealand and the US to open key agricultural sectors substantially, which may be politically difficult.

37 Compare 15 March 2012 entry into force of US-Korea FTA – United States Trade Representative, 'New Opportunities for U.S. Exporters Under the U.S.-Korea Trade Agreement', https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta; versus 1 January 2015 entry into force of Canada-Korea FTA – Department of Foreign Affairs, Trade and Development Canada, 'Canada-Korea Free Trade Agreement (CKFTA)' www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/korea-coree/index.aspx?lang=eng. See also 'Free Trade with South Korea is here. Are Canadian firms ready?' *Globe and Mail* (10 February 2015) www.theglobeandmail.com/globe-debate/free-trade-with-south-korea-is-here-are-canadian-firms-ready/article22887324/.

38 For the US, the strategy has been somewhat opposite. Its FTA with Korea represented a significant breakthrough and the TPP has been a major priority to counterbalance the growing economic importance of China. The TTIP is now emerging as the next significant area of interest.

39 Department of Foreign Affairs, Trade and Development Canada, 'Canada-European Union: Comprehensive Economic and Trade Agreement (CETA)' www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/toc-tdm.aspx?lang=eng at Ch 10, Art 7, Ch 11, Art 4 and Ch 15, Art 4 accessed 11 May 2015. (There are slight differences, largely formatting, between the Canadian published text and the version published by the EU at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.)

ratification by the Canadian and EU parliaments.[40] While the ratification process is expected to run into 2016 and possibly beyond, CETA contains a mechanism that could allow the entire agreement to take effect through 'provisional application' before full ratification is completed.[41]

CETA is a broad and ambitious agreement. A joint study commissioned by the European Commission and the Government of Canada estimated that within seven years, CETA could lead to an increase of more than 20 per cent in Canada-EU trade (estimated in 2007 as a growth of €17bn in EU exports to Canada and €8.6bn in Canadian exports to the EU),[42] grow Canada's economy (GDP) by 0.77 per cent (€8.2bn) and grow the EU economy by 0.08 per cent (€11.6bn). The agreement contains significant concessions from both sides, giving rise to new business opportunities. We focus here on seven areas that are likely to be most significant for companies and their legal advisers.

Tariff reductions

Tariff reduction or elimination is a core feature of most trade agreements including the EU Treaty[43] and NAFTA. CETA is no exception:

40 Unlike individual EU Member States, Canadian provinces are not signatories to CETA. The Government of Canada is the sole Canadian signatory and also bears the liability for any breaches of international trade agreements caused by provincial government action in areas of provincial responsibility. Under Canadian law, legislative competence is divided between the federal and provincial governments. The federal government has the authority to negotiate and conclude international agreements, but this does not require the provincial governments to implement the agreements. This can lead to the federal government being in the difficult position of having made international commitments that it does not have the authority to honour (see John Currie, *Public International Law* (2nd edn, Toronto: Irwin Law 2008), 235–246). For example, the province of Newfoundland is currently boycotting the CETA implementation discussions with the Canadian and other provincial governments and is refusing to repeal the minimum processing rules for fish plants that Canada agreed in the CETA would be removed. See, eg, Peter Shawn Taylor, 'Newfoundland is holding the Canada-Europe freetrade talks hostage' *Canadian Business* (11 March 2015) www.canadianbusiness.com/blogs-and-comment/newfoundland-is-holding-ceta-hostage. The minimum processing requirements (MPRs) were enacted to protect jobs in Newfoundland fish plants. Currently, Newfoundland law requires fish intended for sale outside the province to receive certain minimum levels of processing within the province. See Newfoundland and Labrador Regulation 33/08, RR NFLD 33/08, www.assembly.nl.ca/legislation/sr/annualregs/2008/nr080033.htm.

41 CETA at Ch 34, Art 6.3.

42 The European Commission and the Government of Canada, 'Assessing the costs and benefits of a closer EU – Canada economic partnership' (2008) http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141032.pdf, at p vi.

43 Treaty on the Functioning of the European Union (2012) http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2012.326.01.0001.01.ENG#C_2012326EN.01004701

- Upon entry into force, the EU and Canada will each remove duties on 98 per cent of their non-agricultural tariff lines.[44] Significant, but (albeit not complete) tariff concessions have also been made in politically sensitive sectors such as automotive and agriculture.
- Canadian duties on imports of EU autos will drop from 6.1 per cent to 0 per cent over eight years. EU duties on imports of Canadian autos will drop from 10 per cent to 0 per cent over six to eight years (depending on the type of vehicle). Moreover, an annual quota of Canadian auto exports will benefit from a very liberal definition of 'Canadian origin'. This definition was developed in recognition of the extensive auto supply chain integration in North America and will allow up to 100,000 vehicles per year to be exported from Canada to the EU with as little as 20 per cent Canadian content (based on cost).[45]
- On agricultural products, tariffs will be eliminated for nearly 94 per cent of EU tariff lines and 92 per cent of Canadian tariff lines.[46] Notable tariffs to be removed entirely include those on wine, spirits and fish.[47] However, duties on poultry and eggs will remain in both directions. The EU will maintain quotas (and associated high duties for 'over quota' goods) on beef, pork and sweetcorn.[48] Similarly, Canadian quotas will remain on most dairy products, although there is a significant increase in the quota of cheese allowed to be imported from the EU at low rates of duty.[49] While advocacy groups in the EU have expressed concerns about CETA's impact on laws governing the importation of genetically modified foods,[50] the European Commission asserts that it will not be required to relax its basic laws relating to genetically modified organisms.[51]

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44 Department of Foreign Affairs, Trade and Development Canada, 'Canada-European Union: Comprehensive Economic and Trade Agreement (CETA) – Technical Summary' (10 November 2014) http://international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/understanding-comprendre/technical-technique.aspx?lang=eng#p1 ('CETA Technical Summary'). By seven years after entry into force, 99 per cent of non-agricultural product lines will be duty free.

45 CETA, see n 38 above, at Ch 4, Annex 1 – Product-Specific Rules of Origin, Appendix 1: Origin Quotas and Alternatives to Annex 1 – Product-Specific Rules of Origin, Section D, Table D.1.

46 CETA, see n 38 above, at Ch 9, Art 5.2. The CETA also prohibits agricultural export subsidies for goods after their tariffs are eliminated.

47 CETA Technical Summary, see n 43, at 4.

48 *Ibid* 10.

49 *Ibid* 9.

50 Fiona Harvey, 'EU under pressure to allow GM food imports from US and Canada' (5 September 2014) www.theguardian.com/environment/2014/sep/05/eu-gm-food-imports-us-canada.

51 European Commission, 'EU-Canada Comprehensive Economic and Trade Agreement (CETA)' (last updated 19 December 2014) http://ec.europa.eu/trade/policy/in-focus/ceta/.

Cumulation rules of origin

One of the most innovative elements of CETA is a rules-of-origin framework that can act as a platform to grow the Canada-EU trading bloc through future trade agreements with additional countries by allowing cumulative origin. The cumulation of origin framework effectively allows some of the benefits of a plurilateral trade agreement to be built incrementally, one bilateral agreement at a time.

The value of the EU, Canadian and the third-country components will be cumulated for origin purposes (and therefore the goods will be eligible for preferential benefits applicable to CETA origin goods, such as tariff-free treatment), where:

- the EU and Canada both have free trade agreements with a third country; and
- those third-country agreements also provide for cumulation of origin.[52]

In its current form, NAFTA will not meet the second condition noted above, because it does not provide for cumulative origin. CETA does, however, recognise the tight integration of the supply chains for certain industries by providing that, so long as both the EU and Canada have a free trade agreement with the US (regardless of whether that agreement provides for cumulative origin), material originating in the US can be cumulated in certain situations with EU and Canadian materials for origin purposes under the CETA.[53] This means that, if and when the TTIP is concluded, US material in these sectors will be considered 'originating' under CETA, regardless of whether the TTIP provides for cumulative origin, and despite the fact that NAFTA does not contemplate cumulative origin.

The removal of tariffs and the potential for cumulation of origin in the CETA will facilitate sales of a wide range of goods between Canada and the EU. It will also create opportunities for more efficient supply chains for various assembled products. However, careful attention will need to be paid to the technicalities of rules of origin as well as related taxation and customs compliance issues in supply, distribution and other commercial agreements.

Public procurement

Canada and the EU are both signatories to the WTO Agreement on Government Procurement ('WTO AGP'). It requires that eligible suppliers

52 CETA, see n 38 above, at Ch 4, Arts 3.8 and 3.9.

53 Types of US material that can be considered originating under CETA include some types of automotive products – meat, prepared meats and some preparations of vegetables (CETA, see n 38 above, at Ch 4, Art 3.10 and Annex 1 – Product-Specific Rules of Origin, Appendix 1: Origin Quotas and Alternatives to Annex 1 – Product-Specific Rules of Origin).

be allowed to compete freely in federal-level procurements above specified thresholds. The current threshold for goods or services contracts is approximately €165,000.[54] CETA does not change these thresholds, but will extend procurement rules to the sub-federal level (as discussed in more detail below).

The WTO AGP also requires that parties make available a review process that provides a reasonably prompt and effective way for foreign suppliers to have bid decisions reviewed for compliance with the non-discrimination provisions.[55] CETA parties have both done so:

- Canada has a mature procurement dispute resolution process for most federal level procurements, as required by the WTO AGP as well as NAFTA and other Canadian trade agreements. The Canadian International Trade Tribunal (CITT) is the quasi-judicial body charged with hearing and deciding complaints for federal procurements in Canada. The complainant must either file a complaint within ten days of learning the basis of the complaint, or it must object directly to the procuring entity and then file a detailed complaint within ten days of the denial of the objection.[56] The CITT then does a preliminary vetting of the complaint to determine if it warrants further investigation. If so, the government is required to respond on behalf of its procuring agency and the complainant is permitted to file a reply. Intervention by interested parties (such as the successful bidder whose contract is being challenged) may also be allowed. The CITT will generally issue a decision within 90 days. If the complaint is valid, the CITT may recommend[57] a wide variety of remedies such as re-evaluation of a bid, directing the award of a contract or the payment of compensation to the complainant.[58] There is currently no comparable regime for provincial or municipal procurements, but this is expected to change as a result of the CETA.

54 World Trade Organization, The Plurilateral Agreement on Government Procurement https://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm#cane (accessed 4 June 2015) ('WGO AGP'). See Appendix 1 – Annex 1 of both Canada and the EU.

55 *Ibid* Art XIII.

56 Canadian International Trade Tribunal Procurement Inquiry Regulations, SOR/93-602, s 6.

57 While the CITT 'recommends' rather than 'orders', the federal government is required to 'implement the recommendations to the greatest extent possible': Canadian International Trade Tribunal Act, RSC 1985, c 47 (4th Supp) (CITT Act), s 30.18(1).

58 CITT Act, see n 56 above, s 30.15(2).

- The European Commission has issued directives that set minimum levels of protection that the EU Member States must adhere to in procurements.[59] The directives share some of the features of the Canadian procurement review regime, including short timeframes for complaints and responses,[60] and a flexible range of available remedies.[61] Beyond these basic requirements, Member States can and do employ differing national procurement review mechanisms. A few Member States have created specialised bodies responsible for the enforcement of procurement rules, but many Member States rely on their courts to deal with procurement challenges.[62]

The public procurement provisions in CETA will extend the protections for foreign suppliers substantially by requiring sub-federal government entities to comply with the non-discrimination rules and bid review processes. Such entities will include state, regional/provincial and local/municipal governments, as well as the public-controlled components of the health sector.[63] The minimum thresholds for procurement of goods and services by sub-federal governments to become subject to the CETA standards are, in most cases, 50 per cent higher than the existing thresholds under the WTO AGP and NAFTA for federal level procurements.[64]

Despite, the higher thresholds, a large volume of sub-federal procurements will be brought onto a level playing field. The EU's aggregate public procurement market is estimated to be the largest in the world.[65] Recent

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59 See particularly (i) EU Directive 89/665/EEC on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts: European Union, 'Council Directive' (21 December 1989). http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1989L0665:20080109:en:PDF; and (ii) EU Directive 92/13/EEC coordinating the laws, regulations and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors: European Union 'European Procurement Directives' (25 February 1992). www.eipa.nl/Topics/Procurement/Directive%2092-13-EEC.pdf.

60 *Ibid* EU Directive 89/665/EEC, Arts 2c and 2f(1).

61 *Ibid* EU Directive 89/665/EEC, Arts 2(1) and 2d.

62 Sue Arrowsmith (ed), *EU Public Procurement Law: An Introduction* https://www.nottingham.ac.uk/pprg/documentsarchive/asialinkmaterials/eupublicprocurementlawintroduction.pdf, at p 294 accessed 29 May 2015.

63 CETA, see n 38 above, at Ch 21, Appendices of Market Access Offers. Certain exceptions apply, including in relation to ports and airports, electricity and some 25 per cent of local content requirements.

64 CETA, see n 38 above, at Ch 21, Appendices. The monetary thresholds for public-controlled corporations are nearly triple the existing federal thresholds.

65 The European Commission and the Government of Canada, 'Assessing the Costs and Benefits of a Closer EU – Canada Economic Partnership' (2008) http://trade.ec.europa.eu/doclib/docs/2008/october/tradoc_141032.pdf, ('Joint Study'), at p 74.

estimates put the total value at C$3.3tn.[66] In 2005, the procurements advertised in the EU's *Official Journal* alone totalled approximately €320bn.[67] The Canadian government procurement market is smaller, but still significant. In fiscal year 2013–14, the Government of Canada's primary procurement department issued C$151bn worth of contracts with values between C$25,000 and C$2bn.[68] Spending on sub-federal procurements is understood to exceed federal spending significantly.[69] By way of example, in the 2011–2012 fiscal year, the provincial and territorial governments collectively spent more than double the amount spent by the federal government.[70] This comparison excludes the many Canadian sub-federal procuring entities such as municipalities, municipal organisations, school boards and publicly funded academic, health and social service entities, which also make substantial purchases.

In summary, companies that supply products to the broad range of government-related entities covered by the CETA procurement disciplines should find that Canada and the EU will become much more attractive markets for exports and/or investments. Familiarity with local bidding and procurement rules and practices, as well as the CETA standards and the highly time-sensitive domestic bid review processes will be important at all stages of government procurement processes, as well as in commercial dealings and contracts with distributors, agents or other intermediaries who are assisting with such bids.

Intellectual property rights

CETA increases protection for several types of intellectual property. The most notable changes include:

- Patents – CETA extends the possible term of patent protection to partially account for the lag between patent filing and first market authorisation

66 Department of Foreign Affairs, Trade and Development Canada, 'Opening New Government Procurement Markets in Europe to World-Class Canadian Companies' www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/benefits-avantages/procurement-approvisionnement.aspx?lang=eng.

67 Joint Study, see n 64 above, at 74.

68 Canadian International Trade Tribunal, 'Annual Report for the Fiscal Year Ending March 31, 2014' www.citt.gc.ca/sites/default/files/ar2o_e_0.pdf, at p 29.

69 Joint Study, see n 64 above, at 74.

70 Based on statistics gathered on the basis of Canada's Agreement on Internal Trade (which has lower thresholds than the CETA and a different scope of coverage). See Marketplace Canada (MARCAN), Statistics on Procurement, www.marcan.net/en/statistics/Totals%20by%20year_Aggregate%20values_Table_en.pdf. The thresholds are C$25,000 for goods and C$100,000 for services or constructions. See Agreement on Internal Trade, https://www.ic.gc.ca/eic/site/ait-aci.nsf/eng/il00006.html, Art 502.

for pharmaceuticals by between two and five years.[71] The extended term for patent protection may encourage research and development (R&D) investments, although it may be somewhat of a setback for generic manufacturers whose business model is based on releasing competing products as soon as patent protection has expired.
- Geographical indications – Canada has agreed to recognise and protect approximately 130 geographical indications for European agricultural products, such as 'asiago', 'gorgonzola' and 'Huile d'olive de Haute Provence'.[72] Currently, geographical indications protected under Canadian law are limited to wine or spirits.[73]
- Industrial designs – Canada is not yet a party to the Hague Agreement on Industrial Designs,[74] but has agreed to 'make all reasonable efforts to accede' to the Geneva Act of that agreement.[75]

These provisions are largely concessions by Canada to increase intellectual property protections in favour of EU rightsholders. This should increase Canada's attractiveness as an investment destination in such areas. In addition, it would be reasonable to expect that the exports of products with the protected geographical indications will be enhanced. Assuming that Canadian law is modified to recognise geographical indications generally, a surge of registrations may well occur.

Trade in services

CETA liberalises trade in services both generally and in various specific sectors. The core approach is to establish national treatment obligations that guard against discrimination relative to domestic suppliers, as well as MFN obligations, which ensure that the suppliers from a CETA jurisdiction will be treated as favourably as suppliers from any other jurisdiction.[76] Given the federal/provincial division of powers under Canada's constitution, the provinces have important areas of regulatory authority. CETA provides significant transparency with regard to provincial market access for services (subject to various reservations).[77]

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71 CETA, see n 38 above, at Ch 22, Art 9.2.

72 *Ibid* Annex I, Part A.

73 Trade-marks Act, RSC 1985, c T-13, s 2.

74 World Intellectual Property Organization, 'Contracting Parties – Hague Agreement' www.wipo.int/treaties/en/ShowResults.jsp?&treaty_id=9 (accessed 10 June 2015).

75 CETA, see n 38 above, at Ch 22, Art 8.1.

76 CETA, see n 38 above, at Ch 11, Arts 2 and 4.

77 European Commission, 'CETA – Summary of the Final Negotiating Results' (December 2014) http://trade.ec.europa.eu/doclib/docs/2014/december/tradoc_152982.pdf ('EU Commission CETA Summary'), at p 10.

There are detailed chapters dealing with three major sectors:

1. Financial services – the parties have guaranteed that most of their existing regulation will not become more restrictive for service providers of the other party.[78] This chapter specifically incorporates certain provisions from other chapters and applies them to financial services, such as the national and MFN treatment obligations from both the investment and trade in services chapters.[79]
2. International maritime transport – the maritime transport chapter protects the abilities of carriers of the parties to contract with other service providers (including from third countries), such as when arranging for door-to-door transport or in relation to cargo-sharing arrangements.[80] Canada has also provided greater market access, including for dredging,[81] which was formerly limited to Canadian operators.[82]
3. Telecommunications – CETA includes significant commitments regarding openness and access to public telecommunications networks.[83]

Labour mobility is especially critical for the delivery of various types of services. The mobility-related provisions in CETA include the following:

- A permissible length of stay is established for various types of key personnel and business visitors. This period ranges from 90 days to three years depending on the situation, and discretionary extensions are also possible.[84]
- The parties will not impose limits on the number of key personnel and business visitors.[85]
- The temporary entry benefits extend not just to contractual service suppliers but also to a broad range of independent 'professionals' (which includes most natural persons who are 'self-employed').[86]

The CETA also contains a framework for mutual recognition of licensing and qualifications that could be particularly beneficial for professionals.[87] This is a first for Canada.[88] While CETA does not itself provide for the mutual recognition of professional qualifications, it sets out a process whereby the parties can conclude individual mutual recognition agreements related to professional qualifications (MRAs). One of the sources for MRA proposals is

78 CETA, see n 38 above, at Ch 15, Art 6 (subject to express reservations); see also EU Commission CETA Summary, p 10.
79 *Ibid* Arts 3, 4 and 7.
80 CETA, see n 38 above, at Ch 16, Art 2.
81 *Ibid* Ch 21, Canada Market Access Appendix, Annex 6, fn 1.
82 EU Commission CETA Summary, see n 76 above, at 9.
83 CETA, see n 38 above, at Ch 17, Art 2.
84 *Ibid* Ch 12, Art 7.
85 *Ibid* Ch 12, Art 7.2.
86 *Ibid* Ch 12, Arts 1.2 and 6.1(c).
87 *Ibid* Ch 13.
88 CETA Technical Summary, see n 43 above, at 13.

expected to be joint recommendations advanced by sector-specific regulatory bodies in Canada and the EU.[89] CETA sets out guidelines for what is to be contained in such a joint recommendation and a four-step decision-making process for the recognition of qualifications.[90] It will be important for firms to engage with their domestic regulatory and self-regulatory bodies if they want to encourage the reduction of such barriers (or if they have concerns about the MRA process).

Development of common standards

CETA generally does not require regulatory convergence, but it contains a variety of provisions that encourage and facilitate this objective. This theme underlies the following chapters:

- Chapter 6 ('Technical Barriers to Trade') – the bulk of this chapter aims to increase regulatory cooperation, including a specific annex addressing automotive regulation[91] as well as by increasing transparency in the regulation-making process.[92]
- Chapter 7 ('Sanitary and Phytosanitary Measures') – this chapter aids the adoption of common standards by expressly providing for reciprocal recognition of equivalent sanitary and phytosanitary (SPS) practices[93] and by requiring the transparent provision of certain information about SPS requirements for importation.[94]
- Chapter 8 ('Customs and Trade Facilitation') – this chapter addresses many of the same topics as the recent WTO Agreement on Trade Facilitation[95] (TFA) including procedures for the efficient release of goods,[96] advance rulings[97] and review of decisions of customs officials.[98] In general, the CETA's provisions are less detailed than the TFA provisions, but they were completed at a time when the prospects for the TFA were uncertain and provide a useful fallback if the TFA is not implemented fully on a timely basis.

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89 CETA, see n 38 above, at Ch 13, Art 3.

90 *Ibid* Ch 13, Annex.

91 *Ibid* Ch 6, Annex: Cooperation in the Field of Motor Vehicle Regulation.

92 *Ibid* Ch 6, Art 6.

93 *Ibid* Ch 7, Art 7.

94 *Ibid* Ch 7, Art 8.

95 World Trade Organization, Trade Facilitation Agreement (adopted 27 November 2014, not yet in force), published as Annex 1A in the Marrakesh Agreement Establishing the World Trade Organization (TFA).

96 TFA, at Art 7; and CETA, at Ch 8, Art 3.

97 TFA, at Art 3; and CETA, at Ch 8, Art 9.

98 TFA, at Art 4; and CETA, at Ch 8, Art 10.

The regulatory convergence theme is also expressly dealt with in CETA Chapter 26 ('Regulatory Cooperation'). This chapter sets out the general objectives of regulatory cooperation, lays out expectations for activities the parties will undertake to foster regulatory cooperation[99] and establishes a 'Regulatory Cooperation Forum', which is charged with facilitating regulatory cooperation across the spectrum of the parties' regulatory activities.[100] For private sector participants, the key action items will be monitoring sector developments and considering whether to engage to either support or put forward concerns about possible convergence initiatives.

Investments

CETA includes a significant reduction in the reach of Canada's foreign investment review regime, as well as robust investment protection provisions accompanied by an investor-state dispute settlement (ISDS) mechanism, which have become a source of political and media controversy.

Foreign investment review

The Investment Canada Act (ICA) requires that direct acquisitions of control of Canadian businesses with an enterprise value of C$600m be reviewed and approved on the basis of a 'net benefit to Canada' standard.[101] This threshold replaced the C$369m (book value of assets) threshold in April 2015 and will automatically increase further to C$800m in 2017 and C$1bn in 2019.[102]

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99 CETA, see n 38 above, at Ch 26, Art 4.

100 *Ibid* Art 6.

101 There are substantially lower (asset book value) thresholds (C$5m for direct acquisitions and C$50m for indirect acquisitions) in the cultural sector and in cases where neither the investor nor the vendor is controlled by citizens of WTO member countries: see Investment Canada Act, RSC 1985 c 28 (1st Supp), ss 14(3) and 14.1. State-owned enterprises from WTO member countries are subject to a C$369m (asset book value) threshold (which is indexed for inflation) rather than the new enterprise value threshold.

102 Bill C-60: Economic Action Plan 2013 Act, No 1, 41st Parliament, 1st Session (Royal Assent on 26 June 2013), s 137(1), amending the Investment Canada Act, s 14.1. The Canadian Government also maintains the ability to conduct reviews of foreign investments of any size or structure that may affect Canada's national security: Investment Canada Act, Part IV.1. The lower thresholds applicable to the cultural sector, non-WTO investors and SOEs will not change, nor will the national security provisions (see generally Neil Campbell et al, 'Changes to *Investment Canada Act* Thresholds, Filing Requirements and National Security Review Thresholds' *McMillan LLP Bulletin* (March 2015) www.mcmillan.ca/Changes-to-Investment-Canada-Act-Thresholds-Filing-Requirements-and-National-Security-Review-Thresholds).

For investments involving EU investors or vendors, the CETA will raise the review threshold to having an enterprise value of the Canadian business of $1.5bn.[103] This is a dramatic further increase.[104] In recent years, approximately 10–20 transactions per year have been subject to review.[105] Under the CETA thresholds, it will be rare for any EU investor or vendor to have a transaction subject to review under the ICA (outside the national security, state-owned enterprise (SOE) and cultural areas).[106] This will simplify M&A transactions and potentially put EU firms in an advantaged position when negotiating or participating in an auction to purchase a Canadian business that would exceed the non-EU review thresholds.

Investment protections investor-state dispute settlement

Bilateral investment treaties have a long history as mechanisms to protect capital-exporting countries from the risks of unfair or discriminatory treatment by host states. Beginning with the Canada-US FTA,[107] and then NAFTA,[108] investment protection provisions were integrated into broader free trade agreements. This is a sensible approach since trade and investment activities are often complementary and liberalised rules are beneficial in both areas.

CETA includes a suite of investment protections that are typically contained in modern investment and trade agreements:

- national treatment (ie, non-discrimination relative to domestic investors);
- MFN treatment (ie, non-discrimination relative to investors from other foreign jurisdictions);
- fair and equitable treatment (typically expressed as being in accordance with minimum standards);[109]

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103 CETA, see n 38 above, at Ch 35, Annex I, Canada Federal Annex I, para 1.

104 Certain other jurisdictions within MFN protection will also benefit from this increase. The most notable will be the US and Mexico under NAFTA, see n 2 above, at Art 1103.

105 See Industry Canada, 'Investment Canada Act – Decisions' (12 December 2013) www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00014.html. (This statistic excludes cultural sector and national security reviews.)

106 See nn 100 and 101 above.

107 Canada-United States of America Free Trade Agreement (entered into force 1 January 1989), Chapter 16, www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/cusfta-e.pdf.

108 NAFTA, n 2 above, Ch 11.

109 See, eg, NAFTA, n 2 above, at Art 1105: '(1) Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security'; see also NAFTA Free Trade Commission, 'Notes of Interpretation of Certain Chapter 11 Provisions' (31 July 2001) www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/NAFTA-Interpr.aspx?lang=eng.

- freedom to repatriate profits;
- limitations on the imposition of performance requirements (ie, requirements to purchase or use specified levels of local content); and
- compensation for expropriation (or measures treatment to expropriation).[110]

Investment provisions are subject to normal government-to-government dispute settlement procedures under the applicable investment or trade agreements. However, such proceedings are relatively rare. ISDS is often also included (as in CETA[111]) because investment-related disputes may involve serious impacts on individual investors without necessarily being a priority for action by their home governments (eg, due to scarce resources, the size of the dispute, litigation uncertainty and broader foreign/economic/trade policy considerations).[112]

Investor-state dispute settlement

France and Germany have expressed concerns over ISDS, which could delay CETA's implementation (as discussed more fully below). This appears to be motivated by a concern about the precedential effect of such provisions in the TTIP negotiations with the United States. Interestingly, Chapter 11 of NAFTA has also generated periodic controversy, particularly from interest groups in Canada who perceived that it could allow foreign investors to bypass domestic courts and directly challenge government regulatory actions before international arbitral tribunals although very few cases have been successful.

Arbitration of investor-state disputes was typically included in investment protection agreements because domestic courts might not adequately protect foreign investors.[113]

The WTO's Agreement on Trade-Related Investment Measures (TRIMs)[114] did not include ISDS. An effort to develop a multilateral agreement on investment with ISDS through the Organisation for Economic Co-operation and Development (OECD) was also unsuccessful, in large part as a result

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110 See, eg, NAFTA, n 2 above, at Ch 11, Arts 1102, 1103, 1105, 1106, 1109 and 1110; as compared to CETA, n 38 above, at Ch 10, Arts 5, 6, 7, 9, 11 and 12 .

111 CETA, n 38 above, Ch 10, Arts 17–43.

112 European Commission, Factsheet on Investor-State Dispute Resolution (3 October 2013), http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151791.pdf, at p 3.

113 Office of the US Trade Representative, 'Investor-State Dispute Settlement – Why aren't local courts enough' (March 2015), https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2015/march/investor-state-dispute-settlement-isds.

114 Agreement on Trade-Related Investment Measures (15 April 1994), published in 'Marrakesh Agreement Establishing the World Trade Organization', Annex 1A, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* 143 (1999) 1868 UNTS 186.

of a lack of political willingness to provide ISDS protections in the face of opposition from 'civil society' constituencies.[115]

Critics of ISDS argue that it allows foreign investors to sue national governments for regulating and pursuing public policy objectives (eg, protecting health, safety or the environment) if they negatively affect investors. In fact, investment protections do not preclude governments from acting as they see fit in all areas of public policy; they merely require that investors be fairly compensated if their existing investments are expropriated or severely damaged by such activities. Nor does ISDS create a wide-ranging general right to challenge rules or regulations; it simply provides for compensation if certain minimum levels of protection are not provided to investors and their investments.

ISDS effectively privatises the enforcement process by requiring investors who have a concern to decide whether to expend the time and cost, and bear the outcome uncertainty associated with their claim. ISDS already exists in thousands of investment agreements around the world,[116] including numerous bilateral investment treaties (BITs) negotiated by countries such as the US, Canada, Germany, France, Japan and many others:

- Canada – the Canadian Government has consistently pursued investment protections with ISDS both in its bilateral 'Foreign Investment Protection and Prevention Agreements' (FIPAs) – most recently and significantly with China[117] – and in free trade agreements such as the Canada-Chile FTA.[118] Canada now has 36 FIPAs in force, or signed, and another 18 in which negotiations have concluded or are ongoing.[119] It continues to negotiate

115 See, eg, UNCTAD, 'Member States and civil society call for reform of investor state dispute settlement' (6 November 2014), http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=879&Sitemap_x0020_Taxonomy=CSO.

116 Jonathan Weisman, 'Trans-Pacific Partnership Seen as Door for Foreign Investment' (25 March 2015) www.nytimes.com/2015/03/26/business/trans-pacific-partnership-seen-as-door-for-foreign-suits-against-us.html?_r=0.

117 Department of Foreign Affairs, Trade and Development Canada, 'Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments' (4 November 2014) www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-text-chine.aspx?lang=eng. For commentary, see Neil Campbell and Robert Wisner, 'Canada and China conclude major investment treaty negotiations' *McMillan LLP Bulletin* (February 2012) www.mcmillan.ca/Canada-and-China-conclude-major-investment-treaty-negotiations.

118 Department of Foreign Affairs, Trade and Development Canada, 'Canada-Chile Free Trade Agreement' (28 August 2013) www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/chile-chili/menu.aspx?lang=eng.

119 Department of Foreign Affairs, Trade and Development Canada, 'Foreign Investment Promotion and Protection (FIPAs)' (last updated 27 May 2015) www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/index.aspx?lang=eng.

these agreements, including ISDS mechanisms, despite having been sued by foreign investors on a number of occasions and having settled two such cases by agreeing to pay compensation to injured US investors.[120] The CETA investment protection provisions are consistent with the current Conservative government's well-established approach to investment liberalisation. If the government is re-elected in the fall 2015 election it should not have any difficulty obtaining ratification of the CETA with the investment provisions that were agreed upon.

- US – the US is an enormous capital exporting country and has been deeply committed to protecting outbound investment through the pursuit of BITs. There are now 40 US BITs in force,[121] and six BITs that are signed but not yet in force. Negotiations continue in respect of a US-China BIT.[122] Investment protections supported by ISDS would be an expected component of a TTIP. The US has been a strong proponent of investor-state dispute resolution in general[123] and has been seeking to include it in the TTIP.[124] It considers itself a 'leader in developing carefully crafted ISDS provisions'.[125]

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120 See *AbibitiBowater Inc v Government of Canada* (2010) consent award (for settlement document, see www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/abitibi-03.pdf); and *Ethyl Corporation v Government of Canada* (1998) (for settlement documents, see www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/ethyl.aspx?lang=eng). For a commentary on Canada's investment protection history under NAFTA and various FIPAs, see Neil Campbell and Robert Wisner, 'Canada' in Dennis Campbell (ed), *International Protection of Foreign Investment*, looseleaf (Huntington, NY: Juris Publishing Inc 2010).

121 United Nations, 'UNCTAD Investment Policy Hub', http://investmentpolicyhub.unctad.org/IIA/CountryBits/223#iiaInnerMenu ('UNCTAD Investment Policy').

122 United States Trade Representative, 'Remarks by Ambassador Michael Froman to AmCham China and the US Chamber of Commerce' (27 April 2015) https://ustr.gov/about-us/policy-offices/press-office/speechestranscripts/2015/april/remarks-ambassador-michael.

123 Office of the United States Trade Representative, 'Investor-State Dispute Settlement (ISDS)' (March 2015) https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2015/march/investor-state-dispute-settlement-isds; Office of the United States Trade Representative, 'The Facts on Investor-State Dispute Settlement' (March 2014) https://ustr.gov/about-us/policy-offices/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors.

124 Office of the United States Trade Representative, 'T-TIP Issue-by-Issue Information Centre – Investment' https://ustr.gov/trade-agreements/free-trade-agreements/transatlantic-trade-and-investment-partnership-t-tip/t-tip-5 accessed 10 June 2015.

125 Office of the United States Trade Representative, 'The Facts on Investor-State Dispute Settlement' (March 2014) https://ustr.gov/about-us/policy-offices/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors.

- Germany – no country in the world has more BITs than Germany.[126] Since West Germany signed the world's first BIT with Pakistan in 1959,[127] Germany has concluded 155 BITs, 131 of which are currently in force.[128] Most recently, Germany signed BITs with Iraq and Congo in 2010, although neither agreement is yet in force.[129] Despite being one of the world's leading capital exporting countries and a strong proponent of BITs, Germany has emerged as a focal point for concerns about the ISDS provisions in the CETA.[130] Germany does not have an investment protection agreement with Canada, or with the United States and a number of other developed countries. Germany has embraced ISDS in BITs with developing nations where German investors lack confidence in the host state's judicial system, but has considered it unnecessary to adjudicate investor-state disputes before arbitral tribunals in countries where local laws and courts are capable of providing remedies for investors.[131]
- France – France is also a regular participant in investment agreements. It has concluded 109 BITs since 1960, 95 of which are in force.[132] It most recently signed a BIT with Colombia in 2014 that is not yet in force.[133]

The CETA has been described by the European Commission as providing 'clearer and more precise investment protection standards, *i.e.* the rules, as set out in the CETA, that arbitration tribunals will apply' and 'new and clearer rules on the conduct of procedures in arbitration tribunals'. [134] For example, as compared to NAFTA, the CETA provides:

- additional guidance as to what constitutes a breach of the obligation for 'fair and equitable treatment';[135]
- more detailed definitions, including of 'investor';[136] and

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126 Peter Clark, 'Germany throws down gauntlet in CETA investor-state negotiations' *iPolitics* (27 July 2014) www.ipolitics.ca/2014/07/27/germany-throws-down-gauntlet-in-ceta-investor-state-negotiations ('Clark article').

127 Jeswald W Salacuse, 'Bit by Bit: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment In Developing Countries' (1990) 24(3) *The International Lawyer* 655; and Mahnaz Malik, 'The legal monster that lets companies sue countries' *The Guardian* (4 November 2011) www.theguardian.com/commentisfree/2011/nov/04/bilateral-investment-treaties.

128 UNCTAD Investment Policy, n 120 above.

129 *Ibid* 120.

130 See, eg, Clark article, n 125 above.

131 *Ibid.*

132 UNCTAD Investment Policy, n 120 above.

133 *Ibid* 120.

134 European Commission, 'Investment Provisions in the EU-Canada Free Trade Agreement (CETA)' (26 September 2014) http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf.

135 CETA, note 38 above, at Ch 10, Art 9(2).

136 *Ibid* Art 3.

- a requirement that the government that receives a claim must provide the claimant with a 'prompt review of its claim and of the valuation of its investment'.[137]

The CETA approach to ISDS was expected to serve as a model for a similar provision in the TTIP. However, substantial public opposition to ISDS in the EU and also some political and media concern about the issue in the US[138] have resulted in suggestions that the subject could be off the negotiating table in the TTIP.[139] More recent efforts to find a compromise solution include the proposal of the EU Trade Commissioner to establish a permanent Multilateral Investment Court.[140]

In the wake of difficulties with the ISDS aspects of the TTIP negotiations, France and Germany made a joint declaration in January 2015 that the European Commission should make changes to the ISDS in provisions in the CETA as well.[141] This statement contradicts a November 2014 vow by German Economy Minister Sigmar Gabriel that Germany would not stand in the way of ratification of the CETA on the basis of the investment provisions.[142] The CETA legal text is already settled and closed. It remains to be seen what, if any, changes can be made to the provision at the legal scrubbing stage or prior to ratification that would satisfy the concerns of Germany and France. All 28 EU Member States must approve the CETA.

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137 *Ibid* Art 11(4).

138 See, eg, Vicki Needham, 'Democrats urge officials to leave out investor-state dispute provisions in major trade deals', *The Hill* (18 December 2014) http://thehill.com/policy/finance/227561-democrats-urge-nixing-isds-provisions-in-trade-deals; and Open Letter of US and EU of civil society against investor privileges in TTIP (16 December 2013) www.bilaterals.org/?open-letter-of-civil-society.

139 Andrew Grice, 'TTIP: Activists triumph as contentious US free trade deal clause suspended' *The Independent* (13 January 2015) www.independent.co.uk/news/uk/politics/ttip-activists-triumph-as-contentious-us-free-trade-deal-clause-suspended-9976090.html ('Grice article').

140 European Commission, 'Commissioner Malmström consulted the European Parliament on reforms of investment dispute resolution in TTIP and beyond' (6 May 2015) http://trade.ec.europa.eu/doclib/press/index.cfm?id=1303.

141 See Anca Gurzu, 'Canada-EU trade deal faces more tinkering' *MacLean's* (5 May 2015) www.macleans.ca/politics/worldpolitics/canada-eu-trade-deal-faces-more-tinkering/; 'Paris and Berlin call for review of EU-Canada Trade Deal' *EurActiv* (30 January 2015) www.euractiv.com/sections/trade-society/paris-and-berlin-call-review-eu-canada-trade-deal-311570; Copy of Germany/France Declaration (21 January 2015) www.diplomatie.gouv.fr/fr/politique-etrangere-de-la-france/diplomatie-economique-et-commerce/actualites-liees-a-la-diplomatie-23093/2015/article/negociations-commerciales-117484.

142 Barrie McKenna, 'Germany won't block Canada-Europe trade deal despite investor-state clause' *The Globe and Mail* (28 November 2014) www.theglobeandmail.com/report-on-business/germany-wont-block-ceta-despite-investor-state-clause/article21835893/.

Implications for investors

The CETA will make Canada a strategically advantageous location for European companies seeking to invest in North America, regardless of whether the TTIP is completed. Acquisitions of significant Canadian businesses will be less likely to be reviewed under the elevated ICA thresholds. More importantly, any investment by European companies in Canada will benefit from the CETA investment protections and will be able to take advantage of NAFTA trade rules when selling into the US. Canadian investments throughout Europe will also benefit from the full range of investment protections.

US-EU Transatlantic Trade and Investment Partnership (TTIP)

President Obama announced that the United States intended to launch TTIP negotiations with the EU in his February 2013 State of the Union address to Congress.[143] Talks began in June 2013 with the aim of concluding negotiations two years later.[144] The ninth round of negotiations was held in New York City in April 2015 and a tenth round, in Brussels, is expected in July 2015.[145] It is not surprising that negotiations will take more than two years given the scope and complexity of the agreement. Because trade between the US and EU is somewhat liberalised already, efforts to harmonise regulations and standards, as well as 'traditional' negotiations about reducing the tariffs that do exist, will touch on politically and economically sensitive areas where the US and EU have longstanding differences.[146]

The three pillars of negotiation

Like the CETA, the TTIP is a 'comprehensive and highstandard agreement'.[147] It has three main pillars of negotiation: market access; regulatory cooperation; and rules.[148]

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143 United States Trade Representative, 'Fact Sheet: United States to Negotiate Transatlantic Trade and Investment Partnership with the European Union' (13 February 2013) https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2013/february/US-EU-TTIP ('USTR Fact Sheet').

144 European Commission, 'How we'll make TTIP happen' (20 March 2015) http://ec.europa.eu/trade/policy/in-focus/ttip/about-ttip/process/#_state-of-play; and Congressional Research Service, n 3 above, at 11.

145 European Commission, 'Report of the Ninth Round of Negotiations' (12 May 2015) http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153437.pdf.

146 See Congressional Research Service, n 3 above, at 6.

147 *Ibid* 1.

148 See *ibid* 11; and European Commission, 'What is TTIP about?' (1 April 2015) http://ec.europa.eu/trade/policy/in-focus/ttip/about-ttip/.

Market access

Like predecessor free trade agreements signed by the EU (including the CETA) and the US, the TTIP would be expected to liberalise trade by reducing remaining tariffs, as well as a wide range of non-tariff barriers. Specific chapters are being negotiated on trade in goods and customs duties, services, public procurement and rules of origin.[149] It can be assumed that the US will want to receive similar or better concessions in these areas as Canada obtained in the CETA, and that the EU will want concessions of comparable value to those being given to the US.

Regulatory cooperation

As with the CETA, opportunities for substantial liberalisation of trade between the US and EU will need to go beyond tariff reduction and consider harmonising standards and reducing technical barriers to trade. By way of example, different approaches to product testing and food safety in the US and the EU impose regulatory non-tariff barriers to transatlantic trade in goods ranging from toys[150] to oysters.[151]

TTIP chapters are being developed on the following specific regulatory subjects:[152]

- regulatory coherence;
- technical barriers to trade;
- food safety and animal and plant health (SPS);
- chemicals;
- cosmetics;
- engineering;
- medical devices;
- pesticides;
- information and communication technology;
- pharmaceuticals;

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149 European Commission, 'Now online – EU negotiating texts in TTIP' (10 February 2015) ('EC – 10 February 2015 news release') http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230.

150 Deutsche Welle, 'Transatlantic trade deal faces an uphill battle in the US' (21 May 2015) www.dw.de/transatlantic-trade-deal-faces-an-uphill-battle-in-the-us/a-18464437: in the US, third party testing ensures that toys meet safety standards; in the EU, toymakers self-certify that they meet safety requirements.

151 'Charlemange: Ships that pass in the night' *The Economist* (13 December 2014) www.economist.com/news/europe/21636061-trade-deal-america-would-be-good-everybody-yet-it-still-may-not-happen-ships-pass: in the US, oyster waters are tested for bacteria, whereas individual oysters are examined in the EU.

152 EC – 10 February 2015 news release, n 148 above.

- textiles; and
- vehicles.[153]

RULES

TTIP negotiators are also crafting 'new rules to make it easier and fairer to export, import and invest'.[154] Chapters falling under this pillar are:[155]
- sustainable development;
- energy and raw materials;
- customs and trade facilitation;
- small and medium-sized enterprises;
- investment protection and ISDS (see further discussion above);
- competition;
- intellectual property and geographical indications; and
- government-to-government dispute settlement.[156]

The outlook for TTIP negotiations

Negotiation of a watershed economic and trade agreement of the scope envisioned for the TTIP is not without significant challenges. An important procedural issue for the US is trade promotion (often called 'fast track') authority (TPA) legislation for both the Trans-Pacific Partnership and TTIP TPA legislation. TPA legislation facilitates negotiation and implementation of free trade agreements in the US by restricting passage of the final agreement to up-or-down votes in Congress without amendments. The TPA legislative process has been contentious,[157] including the US House of Representatives (including many democrats) actually voting down a bill containing trade

153 Of these potential chapters, several have direct parallels in the CETA. Regulatory coherence would seem to cover the same ground as the CETA's Ch 26 'Regulatory Cooperation'; technical barriers to trade are addressed in Ch 6; SPS matters are in Ch 7; information and communication technology are addressed in Ch 17 – 'Telecommunications' and Ch 18 – 'Electronic Commerce' and Ch 28 covers the 'Protocol On The Good Manufacturing Practices For Pharmaceutical Products'.

154 EC – 10 February 2015 news release, n 148 above.

155 *Ibid*.

156 Most of these topics are also covered in the CETA: 'Trade and Sustainable Development' is covered in Ch 23; customs and trade facilitation is dealt with in Ch 8; investment matters are addressed in Ch 10; competition is covered in Ch 19; intellectual property is in Ch 22; and government-to-government dispute resolution is in Ch 33.

157 Decision No 2/2002 at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2000.157.01.0006.01.ENG

promotion authority.[158] On 29 June, President Obama received TPA in relation to the TPP and TTIP.

As TTIP negotiators prepare to meet in July 2015 for a tenth round of talks, it is unclear when, or whether, the two sides will be able to reach a proposed deal. Key issues, such as the inclusion of ISDS,[159] remain unresolved and there is considerable public scrutiny and discontent with TTIP, particularly in the EU.[160] Critics of TTIP on both sides of the Atlantic share concerns (for varied reasons) that efforts to increase regulatory cooperation may lead to agreement at the lowest common denominator between the jurisdictions, thereby watering down standards and protections in areas such as health, culture and the environment.[161] The group 'Stop TTIP' has collected 1.7 million signatures in Europe, including one million in Germany alone.[162] By comparison, the European Commission received approximately 150,000 objections to CETA.[163]

The European Commission's proposal in April 2015 to allow EU Member States to ban genetically modified organisms (GMOs) for non-scientific reasons may also affect the TTIP negotiations. The EU's chief TTIP negotiator, Ignacio Garcia-Bercero, asserts that the proposal maintains science-based risk assessment at the European level, in compliance with WTO obligations, while permitting Member States to 'take actions on the

158 Paul Kane et al, 'House Democrats rebuff Obama on trade, delivering major defeat' *Washington Post* (12 June 2015) www.washingtonpost.com/politics/president-obama-is-all-in-on-trade-sees-it-as-a-cornerstone-of-his-legacy/2015/06/12/32b6dce8-1073-11e5-a0dc-2b6f404ff5cf_story.html. While the House approved the actual trade promotion authority component of the bill, the bill was defeated because the House voted against the component of the bill relating to the Trade Adjustment Assistance work assistance programme.

159 Deutsche Welle, 'Germany pledges to stand firm in US-EU TTIP trade talks' (21 March 2015) www.dw.de/germany-pledges-to-stand-firm-in-us-eu-ttip-trade-talks/a-18332349=?maca=en-rss-en-world-4025-rdf/ ('Welle "stand firm" article').

160 Deutsche Welle, 'German activists turn out in force to protest TTIP trade deal' (18 April 2015) www.dw.de/german-activists-turn-out-in-force-to-protest-ttip-trade-deal/a-18391723=?maca=en-aa-pol-863-rdf/ ('Welle "German activists" article').

161 See, eg, Deutsche Welle, 'New round of US-EU free trade talks begins' (13 March 2015) www.dw.de/new-round-of-us-eu-free-trade-talks-begins/a-18394736?maca=en-rss-en-all-1573-xml-atom/; EU Commission – Make TTIP Happen, n 143 above; and Deustsche Welle, 'Chlorine concerts and butter books? TTIP tests Germany's cultural values' (20 May 2015) www.dw.de/chlorine-concerts-and-butter-books-ttip-tests-germanys-cultural-values/a-18462804.

162 Welle 'German activists' article, n 159 above.

163 Deutsche Welle, 'Transatlantic free trade in the balance' (11 November 2014) www.dw.de/transatlantic-free-trade-in-the-balance/a-18056453.

basis of other legitimate reasons'.[164] The United States Trade Representative, Michael Froman, called the proposal 'restrictive… not constructive', and 'hard to reconcile with the EU's international obligations'.[165]

Concluding observations

The potential gains of concluding a TTIP agreement are strategically and economically significant for both the US and the EU. The US-EU economic relationship is the largest in the world. Together, they are responsible for roughly one-third of global trade in goods and services,[166] to which a TTIP might add another US$100bn.[167] While there is no assurance whether or when an agreement will be concluded, it remains a very real possibility. Ratification and implementation of the CETA may also provide some further impetus for the US to complete the negotiations for a TTIP, as could an impasse in the TPP negotiations. In the meantime, the prospects for ratification of CETA appear to be promising, and this will create a wide range of trade and investment companies for both European and Canadian companies.

164 United States Diplomatic Mission to Brazil, 'Press Conference on the 9th Round of Transatlantic Trade and Investment Partnership (TTIP) Negotiations' (24 April 2015) http://brazil.usembassy.gov/ttip.html.

165 United States Trade Representative, 'USTR Expresses Concerns over EU Proposal to Allow Member States to Ban the use of GE Food and Feed Deemed Safe by EU' (April 2015) https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/april/ustr-expresses-concern-over-eu. (In 2006, the WTO ruled that EU authorisation of genetically engineered food and feed must be scientific assessment of risks to human or animal health or to the environment.)

166 USTR TTIP Fact Sheet, n 142 above.

167 Welle 'stand firm' article, n 158 above; Grice article, n 138 above, and the discussion of ISDS in the CETA context above.

Fiscal Transparency – International Business Structures and Issues

Jennifer Wheater and David Sussman*

The concept of otherwise separate parties pooling their resources and working together to share profits has been present as long as business has been conducted. Thus, the idea of a business enterprise that owes its existence not to the state but solely to the arrangements between those involved is not new. In England, certainly, references were made in the 15th century to businesses formed as partnerships but it was not until 1890 that these arrangements were codified by statute. For tax lawyers, the most important feature of the partnership in its traditional sense is its fiscal transparency. Quite simply, for tax purposes it does not exist. Partners contribute to the partnership business, own partnership assets collectively and share profits and losses between themselves in accordance with their own agreement. These profits and losses are taxed at the level of the individual partners.

In the modern world the seemingly simple idea of business by mutual agreement rather than through a separate entity has become subject to new complexities. Various terms may be used to define what is commonly understood to be a partnership – general partnership, limited liability partnership, limited partnership, limited liability limited partnership, etc. How, if at all, do such terms affect fiscal transparency? Equally, other terminology comes into play – the concepts of legal personality and body corporate have added a further dimension to partnerships that are subject to such terms. Additionally, international elements are increasingly important. Entities may be regarded as, or treated as, fiscally transparent for their own domestic purposes but how does this operate in the context of international arrangements or tax treaties? Is there global consistency?

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This article examines the issues related to fiscal transparency in a business context and how these are addressed worldwide. There is an emphasis on the United Kingdom and the United States, but other jurisdictions are also considered in context. This article first focuses on the UK and explains the issues that partnerships have faced in blending fiscal transparency with other considerations. Structures in the US and then other jurisdictions and regions are subsequently examined and the importance of an international perspective is considered. The article then moves to consider current challenges facing partnerships as common reporting becomes standard and the OECD's Base Erosion and Profit Shifting (BEPS) initiative continues. This article considers fiscal transparency in a business context only and thus the focus is on partnerships or similar active business structures. Other transparent entities such as trusts, which are more commonly personal or passive, are beyond the scope of this article. Equally, very specialist transparent vehicles with purely domestic, limited application are not dealt with.

Transparency in the UK

In the UK, as stated above, partnerships have always been used as a business vehicle. The most commonly understood type is the general partnership, which bears all the hallmarks of true absence of existence outside its membership and hence fiscal transparency. The partnership exists solely on the basis of agreement between the members. All members bear unlimited liability for the debts of the partnership and each partner is the agent of each other and of the partnership collectively. The partnership has no legal personality, it is not a body corporate and, on the admission of a new partner or the death or resignation of an existing partner, an entirely new partnership is, technically speaking, created, notwithstanding the fact that it may carry on a business identical to that of the previous partnership.

As business developed, the model of the general partnership was modified. Certain features of a general partnership are highly desirable – transparency for tax purposes being the main one. However, certain others are less palatable. Each partner being the agent of the other and thus able to bind the partnership and the concept of unlimited liability for partnership debts are not always suitable for working relationships, especially as partnerships became larger and more diverse. The English limited partnership added a new dimension. In this model, only one partner, known as the general partner, has unlimited liability and can effectively act for the partnership (there can be more than one general partner but this is relatively unusual). The limited partners enjoy the advantage of liability limited to the amount of their capital contribution to the partnership but, to retain such limited

liability, they are not permitted to take part in the management of the partnership. These structures can be ideal for investment funds such as private equity funds, in which the general partner can appoint a manager and the model is that the investors rely on the general partner and manager and have no intention of entering into a management role. However, the limited partnership could not be used by professional partnerships such as lawyers and accountants, where partners would reasonably expect to be involved in management. Like the general partnership, an English limited partnership has no legal personality and is not a body corporate.

The vehicle of choice for professional partnerships was introduced in 2001 when the limited liability partnership or 'LLP' entered into being. This was an entirely new vehicle, which, unlike the general or limited partnership, has a legal identity separate from its members and is also, in that capacity, a body corporate. Each member has limited liability in that their personal liability had an upper limit of the amount of their capital contribution. Furthermore, LLP members are not agents of each other and cannot bind the LLP. The LLP owes its fiscal transparency to statute and, were an identical foreign vehicle judged for transparency in accordance with UK law (as discussed later), it is unlikely that such vehicle would be accorded transparent treatment.

Scotland has a different legal system from England and Wales, although they are still (at the moment) one jurisdiction for tax purposes. A Scottish partnership differs from an English one in that, under Scottish law, it has a legal personality separate from that of its members, although it is not a body corporate. For income and capital gains tax purposes, the two are treated identically. However, the legal personality makes a crucial difference in certain instances. For example, Scottish partnerships are able to become partners in an English general or limited partnership without the result of simply forming a single, large partnership. This means that fiscal transparency can be retained in a UK structure by use of a Scottish partnership, but partners in a Scottish partnership that is a partner in an English partnership are still able to keep their partnership arrangements between themselves.

UK partnership law

The Partnership Act 1890 (amended and extended by the Limited Partnership Act 1907) is the UK statute that governs partnership law. Many of its provisions are subject to the contrary agreement of the partners – partners have a wide discretion to decide between themselves the terms of their relationship and may agree to adopt different rules than those specified in the Partnership Act. However, there is less discretion in this area where relations with the outside world are concerned. For example, the partners

cannot determine that a partner may not bind the partnership and may not agree to limit certain partners' liabilities for the debts of the partnership. The main function of partnership legislation is to provide a default position for matters not dealt with by agreement between the partners in areas such as division of profits and to deal with certain issues mandatory to general and limited partnerships such as the fact that a new partnership must be formed if a partner dies or retires.

The Limited Liability Partnerships Act 2000 and related regulations address LLPs. The Act makes it clear that while, for income tax and capital gains tax, an LLP is treated as transparent, it has similar requirements to a company in terms of registration, filing of accounts, etc.

Case law has also had to address a number of issues with regard to partnerships. For example, seemingly basic issues such as whether a partnership has been formed and whether certain property constitutes partnership property have been addressed by the UK courts. As UK partnerships have developed in sophistication and size, issues have inevitably arisen in more complex areas. Certain of these, some with international significance, are discussed below.

Is a partnership a person?

Certain elements of UK legislation, from data protection law to tax law, refer to application to 'persons'. This raises the issue of whether a partnership can be regarded as a person. The Interpretation Act 1978 states that the term person includes 'any body of persons corporate or unincorporate'. This seems, by logical inference, to include a partnership. However, certain elements of the tax legislation deal with 'persons' separately from partnerships. For example, section 9 of the Income Tax (Trading and Other Income) Act 2005 states that any farming activity carried on by a person shall be treated as one trade. The same section then cross-refers to another section, which addresses instances in the 'case of farming carried on by a firm' (firm is the term used for a partnership in this legislation). If a partnership is a person for tax purposes the additional language would seem unnecessary. Earlier legislative citations (still post the Interpretation Act) such as section 55 of the Income and Corporation Taxes Act 1988 actually refer to 'person, body of persons or partnership' suggesting, again, that partnership is separate from both. In the case of *Padmore v IRC*,[1] the Court of Appeal, affirming the High Court's decision, found that the taxpayer was exempt from tax on his foreign income from a Jersey-based partnership. This was because the

1 [1989] STC 493.

UK Jersey double tax treaty (an unusual one in terms of wording) exempted a Jersey resident person from UK tax, except for business carried on through a permanent establishment in the UK. In the context of the treaty, 'person' was defined as including a 'body of persons' and it was held that such term included a partnership, despite contrary argument from the UK tax authorities citing law back to 1842 implying that a partnership was not a 'body of persons'. The case did infer, however, in finding a partnership was included as a person by virtue of the definition including 'body of persons', that, in the absence of such inclusion, a partnership may not be a 'person'.

This ambiguity remains and, even in a modern context, issues can arise. The UK transfer pricing legislation, for example, applies to 'persons' and, although, prior to 2005, HMRC treated partnerships as transparent for the purposes of controlling another entity so that control was determined at the partner level, this position abruptly altered and HMRC guidance changed to state that the term 'person' included partnerships. This remains a currently disputed position and the Office of Tax Simplification recommended in January 2015 that it be reviewed.

Stamp taxes

The UK has a number of stamp taxes and the more modern ones, the Stamp Duty Land Tax and the Stamp Duty Reserve Tax, deal specifically with partnerships and other transparent entities. However, Stamp Duty ('SD') itself, the original stamp tax, does not address partnerships as well. SD is payable on documents conveying transfers of partnership interests for consideration where the partnership owns shares or marketable securities. Thus, transfers of interest in partnerships that do not own such assets do not attract SD and SD is not payable if a transfer of an interest is effected without a document or without consideration. The amount of SD payable is based on consideration but subject to a cap of the SD that would have been payable on direct transfer of securities. Transfers of securities are subject to SD at 0.5 per cent. Transfers of partnership interests are subject to SD at graduated rates up to four per cent. Thus, the cap may or may not apply. For example, if consideration for a partnership transfer is £1m and the partnership owns shares worth £1m then SD payable is £5,000 – capped at 0.5 per cent of £1m, that is, what would be paid on transfer of the shares directly and not £40,000 (ie, four per cent of £1m). Conversely, if consideration for the partnership transfer is £100,000 then SD payable is £4,000 – four per cent of £100,000 is lower than the cap of £5,000. This is a somewhat cumbersome system that remains law, but that can be inconvenient in practice.

Internationally, SD can also present an issue. Section 14(4) of the Stamp Act 1891 states that SD applies to 'an instrument executed in any part of the UK, or relating, wheresoever executed, to any property situate, or to any matter or thing done or to be done in any part of the UK'. This potentially broad language could theoretically mean that transfers of partnership interests in other jurisdictions could be subject to UK SD if they, for example, own UK securities or have another connection to the UK.

Generally speaking, there are ways to address SD in the context of partnerships, both in the UK and overseas. The only real disadvantage in not having the document stamped is that a stampable but unstamped document cannot be produced as evidence in a UK court – unlikely to be a pressing concern, especially overseas. However, this potentially broad application of UK SD does remain a residual issue for partnerships in some instances.

Partner or employee?

Individual partners in general partnerships are treated as self-employed and are taxed accordingly. This means that, while income tax and self employment National Insurance Contributions (NICs) are payable, employer NICs at a rate of 13.8 per cent (subject to certain thresholds) are not due, which results in less tax payable on the income of a partner as opposed to an employee of the partnership. The test for whether an individual is a partner is fairly easy to fulfil – an element of capital contribution, the intention to enter into partnership and some say in management are all that is required and each may be merely nominal. In professional partnerships the use of partners who were, in reality, employees in all but title was perceived by HMRC as a growing problem. The LLP legislation and related HMRC guidance made it clear that LLP members were – just as partners in a general partnership – to be regarded as self-employed unless, according to the legislation, they had been a partner in a partnership, in which case they would have been an employee of that partnership. Since a partner in a partnership cannot be an employee, this was held by the courts to relate to a hypothetical partnership in the absence of the relevant LLP member and with the same, easy-to-fulfil tests for partnership. Before the introduction of LLPs, the general partnership model included certain disadvantages to adding innumerable junior-level partners to the partnership. Mutual agency and unlimited liability were sufficient to outweigh the tax incentives of promoting certain employees to partner. With the introduction of the LLP this changed. Members no longer had to deal with the agency and unlimited liability issues and, offered minimal rights, junior partners could be added at no risk to the partnership

and to its tax advantage, saving the 13.8 per cent employer NICs and limiting the individuals' employment rights in addition.

HMRC's response was the introduction of disguised employment legislation targeted at professional LLPs. The new rules came into effect in April 2014 and provide that an LLP member will be a 'salaried member' and thus an employee for all tax purposes if they meet all of three conditions.

Condition A is that there are arrangements in place under which the member is to perform services for the LLP in his or her capacity as a member, and it would be reasonable to expect that the amounts payable by the LLP in respect of the member's performance of those services will be wholly, or substantially wholly, unaffected by the overall profits or losses of the LLP (this is described as 'disguised salary'). Although the term 'substantially wholly' is not defined in the legislation, HMRC guidance has stated that this means 80 per cent or more.

Condition B is that the mutual rights and duties of the members and the LLP and its members do not give the member significant influence over the affairs of the LLP. Guidance suggests that a narrow category of individuals will be regarded as having significant influence in a large LLP.

Condition C is that member's contribution (normally capital) to the LLP is less than 25 per cent of the disguised salary that it is reasonable to expect will be payable by the LLP in a relevant tax year in respect of the member's performance of services for the LLP in his or her capacity as a member of the LLP.

The legislation also contains anti-avoidance provisions meaning any arrangements with a main purpose of circumventing these salaried member rules will be disregarded when applying the rules.

Only LLPs are subject to these rules. In the case of other partnerships, the position remains that the test of being a partner is not onerous.

Workplace rights

Linked to the tax implications of partner or employee status are workplace rights issues. Being self-employed, partners are not eligible for typical employment rights such as rights precluding unfair dismissal, right to maternity leave, etc. However, they are entitled to relief from discrimination by the partnership on the grounds of the relevant protected categories, for example, race and gender. In the context of this area of law, however, there is a third potential classification. Those performing a role may be employees, independent contractors or, between the two, workers. Workers are not entitled to the full suite of employment rights but they do possess certain

rights greater than those of a truly independent contractor, for example, paid holiday. It is currently unclear whether partners can qualify as workers.

In the case of LLP members who are now regarded as 'salaried members' under the new legislation, the judgment in *Tiffin v Lester Aldridge*[2] suggests they could be regarded as employees for employment law purposes. In this case the payment of PAYE was taken into account as a factor in determining if an individual, in a hypothetical partnership without him, would be treated as an employee. Although, technically speaking, employment and tax law may differ in their interpretation of what constitutes an employee, the payment of PAYE and employer NICs in this context is heavily persuasive. However, salaried members of LLPs represent a limited class of partners. Other LLP members or partners in other forms of partnership may vary considerably in their role and status within the partnership. The determination of whether or not they are a worker may be fact specific.

The UK Supreme Court held in *Clyde & Co and Another v Bates van Winkelhof*[3] that a fixed-share partner in an LLP law firm was a 'worker' who was hence protected by whistleblowing laws. The individual in question was a partner in a law firm and was seconded to a Tanzanian law firm, which her firm had acquired. When she told her firm that the managing partner of the Tanzanian firm had accepted bribes, her secondment was ended and she was expelled from the partnership. She brought a claim that she had suffered a detriment for blowing the whistle. However, only 'workers' (including employees) as set out in the UK Employment Rights Act 1996 are protected by whistleblowing laws.

The Supreme Court held that 'workers' in this context are those who have a contract to do or perform personally any work or services for another party under the contract, but which are not the individual's clients or customers. They held that this individual did have a contract to perform work or services personally, that those services were to the LLP and that the LLP was not her client or customer. She could not market her services as a solicitor to anyone else other than the LLP, and was an integral part of their business. The Supreme Court also rejected the idea that the LLP legislation prevented LLP members from being 'workers'.

This case is interesting but it is by no means of universal application. First, the partnership concerned was an LLP as opposed to a general partnership. Secondly, the individual was a 'fixed share' partner and might well have subsequently become a 'salaried member' under the new rules had they been in force at the time. Thirdly, even if she had not become a salaried member,

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2 [2012] EWCA Civ35

3 [2014] UKSC 32.

she was clearly a junior-level partner. Seniority, structure and precise role must make a difference in ascertaining whether a partner can be a 'worker' or not. This renders certain matters difficult for partnerships. Although this case addressed whistleblowing only, the ruling means that certain partners may be considered 'workers' for other rights under the Employment Rights Act 1996 and thus can be accorded the benefit of certain legislation, even if they are not employees. This may require some careful consideration in some cases.

VAT

For Value Added Tax (VAT) purposes, a general partnership can have its own registration as a business carried on by the partners, just as a sole trader can register a business carried on by him. Where matters become more complicated is in the world of limited partnerships and VAT grouping.

An entity can only be part of a VAT group if it is a 'body corporate'. This is distinct from the concept of a legal personality. A body corporate must have 'perpetual succession', meaning that it must continue to exist despite a change in membership or an exit from the business of any owner or member. This is not the case with a partnership, where a new partnership is technically formed on each change in membership. This is true even of a Scottish partnership, which, while it has a legal personality, is not a body corporate. Thus, partnerships cannot be part of a VAT group. An exception is LLPs, owing to their body corporate status.

The case of *H Saunders and TG Sorrell v Customs and Excise Comrs (VTD 913)*[4] held that, in the case of limited partnerships, there is no collective business since the limited partners have no input into management. Accordingly, unlike general partnerships, limited partnerships must register for VAT through the registration of the general partner. The general partner, assuming it is a body corporate, may then become part of a VAT group.

US structures

The US has developed a sophisticated statutory network of fiscally transparent vehicles (often known in US parlance as 'flow through' entities) and an election system in relation to many foreign vehicles.

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4 [1980] VATTR 53.

S corporations

US corporations are taxed under subchapter C of the Internal Revenue Code 1986 as amended (the 'Code'). Domestic corporations with no more than 100 shareholders may elect 'S corporation' status and hence be taxed on a transparent basis. However, there are restrictions in this area. Shareholders must be US citizens or residents and generally may not be corporations or partnerships. In addition, S corporations may have only one class of stock.

General and limited partnerships

Partnerships in the US take a number of forms. The typical general partnership operates in a similar manner to the English general partnership and the limited partnership with a general partner with unlimited liability and at least one limited partner who does not take part in management is also substantively similar. For this reason, American private equity funds are often structured as Delaware limited partnerships, just as English funds frequently take the form of an English limited partnership.

Limited liability companies

Limited liability companies (LLCs) are another extremely popular US vehicle, which are treated as fiscally transparent for US purposes. These have been in place since the 1970s. LLC owners, called 'members', can manage their businesses or hire professional managers. In addition, LLCs enjoy a lot of flexibility. For instance, they can have as many members as they like, and corporations are allowed to be members. LLCs enjoy freedom from the state-mandated membership and management reporting requirements that corporations have. Most important, LLCs, by default and without contrary election, do not have to pay taxes. Instead, their profits and losses are passed through to their members' individual tax returns in the same way as a partnership. As a result, members enjoy the advantages of avoiding the 'double taxation' of corporations as well as receiving tax relief from the poor performance of their LLCs.

Some states require businesses with more than one owner to form as an LLC (an election to be treated as a corporation can be entered into). LLCs offer the benefit of a separation between personal and legal assets and liabilities, since the LLC itself owns the assets of the entity and bears its liabilities. Unlike general partnerships, LLCs must register with their state

secretary of state. LLCs enjoy flexibility in their internal structure and all members are protected from financial liability, regardless of whether they play an active role in the direction of the company. Corporations, other partnerships and individuals may be LLC members.

Limited liability partnerships

Limited liability partnerships in the US ('US LLPs') have the same tax advantages as LLCs. They cannot, however, have corporations as partners. Perhaps the most significant difference between LLCs and US LLPs is that US LLPs must have at least one managing partner who bears liability for the partnership's actions. With a US LLP, whoever is in charge is legally exposed in the same way as owners of a general partnership are exposed. A US LLP format is often used by professional partnerships in which a founding partner or group of partners are in charge and run the firm, while other partners are silent and are admitted as they have earned partnership status. Because these junior partners have no real say over the direction of the firm aside from their personal practice, the LLP protects them from any problems caused by management's decisions. Managing partners usually own a significantly larger share of the company than junior or silent partners since they are responsible for the actions of the partnership. Although both are frequently used as professional partnerships, the US LLP is very different in operation from its UK counterpart, which is more akin to the US LLC.

Limited liability limited partnerships

Limited liability limited partnerships (LLLPs) are relatively new in the US and are intended to combine the features of an LLC and a limited partnership. Similar to a limited partnership, the LLLP consists of one or more general partners and one or more limited partners. The key advantage of this form of ownership is that the general partners receive limited liability on the debts and obligations of the LLLP. The intention is to combine the total limited liability of the LLC with the absence of corporate compliance enjoyed by a partnership.

State law

Most states have adopted uniform legislation in the area of partnerships and other transparent entities. However, it is important to note that the US states retain considerable control over registration and administration of entities organised or doing business in them. Some states, for example, limit the

types of organisation that can form a US LLP to certain professions. In other cases, such as California, the LLLP is not offered as a business form so that businesses wishing to use this structure in that state would need to organise in another state and then conduct their business in California.

Entity classification elections

In the 1990s, the US Treasury Department introduced the entity classification election. These rules are commonly known as the 'check-the-box' rules. While some businesses are automatically classified as corporations, most can choose how they will be classified for federal tax purposes. An eligible entity is any entity recognised for federal tax purposes that is not classified as a trust or as an automatic corporation.

Eligible entities can thus make a classification election. An eligible entity with at least two members can choose to be classified as either 1. an association taxable as a corporation or 2. a partnership. An eligible entity with a single member can choose to be 1. classified as an association taxable as a corporation or 2. disregarded as an entity separate from its owner. If a joint undertaking is considered an entity separate from its owners for federal tax purposes and is an eligible entity, it may elect how it will be classified under these same rules.

As stated above, certain entities are automatically classified as corporations. Most importantly, domestic entities formed under a federal or state law that refers to the entity as incorporated or as a corporation, body corporate or body politic may not elect to be treated other than as a corporation. This means that, domestically, most eligible entities are partnerships or LLCs. An LLC, unless it elects to the contrary, is a partnership if it has more than one member or a sole proprietorship if it is a single-member LLC.

In an international context, foreign entities may also make an entity classification election if they are regarded as 'eligible entities'. In the case of foreign entities, the US retains a list of those that are automatically classified as corporations and thus ineligible to elect. Any other entity may elect. A listed company in the UK is an example of an automatic corporation that cannot alter its status. A private company, on the other hand, can elect its treatment for US tax purposes.

The US entity classification election is a valuable tool in international tax planning. Used effectively, it can combine the desired treatment in the country where the foreign entity is organised with the desired treatment in the US. For example, a US LLC wishing to establish a UK presence could form a subsidiary company and make an entity classification election to treat it as a partnership for US tax purposes. The profits of the subsidiary would

then be taxed at the level of the LLC members, with credit given for the UK corporation tax payable. If this is a new venture then the LLC members could take direct advantage of the initial-year losses. However, in terms of liability, the LLC members are fully protected since, for UK purposes, the entity is a company – the election is relevant for US tax purposes only.

Transparency globally

It is beyond the scope of this article to examine each and every transparent structure worldwide. However, it is important to summarise the position in certain countries and regions to demonstrate that the idea of fiscal transparency is truly global.

Offshore structures

Partnerships, especially private equity fund limited partnerships, may be formed offshore for a variety of reasons. Accordingly, Jersey, Guernsey and the Cayman Islands have well-developed transparent structures, despite the absence of corporation tax meaning that their advantages from a local perspective are small. In Guernsey and Jersey, LLPs are also frequently used.

European structures

In Europe, the concept of fiscal transparency includes partnership structures and also a range of co-ownership vehicles.

In Germany, the Kommanditgesellschaft (KG) is the German equivalent of a limited partnership, with general partners (Komplementär) with unlimited liability and limited partners (Kommanditisten) whose liability is limited to their contribution. General partnerships can take the form of the Gesellschaft bürgerlichen Rechts (GbR) or its trading equivalent the Offene Handelsgesellschaft (OHG). The Gesellschaft mit beschränkter Haftung & Compagnie (GmbH & Co) KG is a limited partnership with, typically, the sole general partner being a limited company. It can thus combine the advantages of a partnership with those of the limited liability of a corporation. Germany also retains the concept of a dormant partnership (Stille Gesellschaft), which arises when a person makes a contribution to an existing enterprise and shares in its profits. The dormant partner has no liability for the debts of the enterprise and in the case of insolvency he is a creditor.

Luxembourg has a number of fiscally transparent structures that can be set up under various specialist regimes, for example, alternative investment structures. Limited partnerships can take the form of the société en

commandite simple (SCS) or the société en commandite speciale (SCSp). The latter does not have legal personality and is not subject to municipal business taxes. General partnerships in Luxembourg are known as either Société Civile or Société en Nom Collectif. The difference between the two types is the size of the business. The first one refers to professional partnerships, while the second one is dedicated to small legal entities. Partners are fully liable for the company's obligations and at the same time they have the right to manage all matters concerning the company.

Given Italy's stance on overseas structures (discussed further below), it can come as a surprise that the idea of a limited partnership derives from Italy's maritime trade. An Italian partnership or Società in Accomandita Semplice (SAS) has both managing and silent partners with managing partners having unlimited liability.

Other European jurisdictions such as the Netherlands, France, Sweden and Spain all have domestic structures that are fiscally transparent. In Eastern Europe too, these structures are typically available with jurisdictions including Ukraine, Hungary and Romania all providing for transparent business entities.

African structures

As with many business law issues, African countries range very widely in their position on partnership structures. Some have no formal partnership law and others, such as South Africa and Mauritius, have well-established vehicles. It appears to be the case that the concept of a partnership in terms of a model of sharing assets, risks and rewards is broadly recognised and there are frequent programmes involving 'partnership' with certain governments with a view to medical or educational provision. However, the business partnership in the sophisticated sense is not widely developed throughout the continent.

Asian and Latin American structures

Asian and Latin American countries generally speaking have fiscally transparent business entities such as partnerships, with China, Hong Kong, Singapore, Colombia, Brazil and others all offering such structures.

Antipodean structures

Both Australia and New Zealand have general and limited partnerships similar to those in the UK and elsewhere. Interestingly, in Australia some of the changes made in English law in this area have not been followed, for

example, in many cases a partnership may still only have 20 partners. The concept of limiting liability does exist through the incorporated limited partnership (ILP). However, the ILP structure tends to be narrowly available and restricted to the investment partnership. Frequently, only certain specialist partnerships may take ILP form, including venture capital limited partnerships (VCLPs), early stage venture capital limited partnerships (ESVCLPs), Australian venture capital fund of funds (AFOFs) and venture capital management partnerships (VCMPs).

International issues for transparent entities

In a global economy, entities must consider their position in the context not only of domestic, but international, legislation. A key question is often how other jurisdictions will treat an entity. What are the implications of a 'mismatch' in treatment? How does this operate in a treaty context? Names, as ever, are deceptive. As has already been noted, the US LLP is very different from its English counterpart and an Indian LLP is a taxable vehicle (although further tax is not levied on the LLP members). A limited partnership, transparent in England, Cayman and many other jurisdictions, is fully taxable in Brazil. Hence, it is crucial in considering transparency in international areas to understand how the specific entities involved work and how the different countries address the issue of transparency of foreign vehicles.

There is no global codification regarding the test of transparency or otherwise of worldwide entities. Accordingly, it is inevitable that different jurisdictions approach this issue in different ways and there can be a range of views on the same structure. In Italy, the answer is simple in that all international entities are treated as opaque – there is no concept of transparency. The US has also adopted a simple test – an entity with at least one member with unlimited liability is transparent. All others are opaque although, as discussed above, entities eligible for an entity classification election may be able to alter their status for US tax purposes. Although more flexible than Italy, this broadly elective approach provides considerable clarity. Other jurisdictions, notably those in Asia, will treat certain overseas structures as transparent but only if a specific ruling is obtained on the issue, applicable only to the entity concerning which the ruling is made. This can often be a cumbersome, expensive and uncertain process and is largely considered to be unattractive if there is any available alternative. Accordingly, it is common to interpose a domestic limited partnership into Asian structures since these are respected as transparent.

In some instances, jurisdiction of organisation as opposed to the type and operation of the vehicle itself makes a difference. For example, Jersey

and English limited partnerships operate in identical ways and have few substantive differences. However, although Spain respects the transparency of an English limited partnership, Jersey's 'tax haven' status means that payments to a Jersey partnership will be subject to Spanish withholding, notwithstanding that the partners may be resident in treaty countries.

The presence or absence of a legal personality is an important factor in many jurisdictions, sometimes critically so. Certain countries adopt the position that all entities with a legal personality are fiscally opaque. Belgium is an example of a jurisdiction in which this is, generally speaking, the case. Thus, a partnership formed in Guernsey that elects to have a legal personality will be regarded by the Belgian authorities as opaque solely on this basis, notwithstanding the fact that, operationally, it is the same as a partnership that has not entered into such election. The importance of the presence or absence of a legal personality was partly behind the decision on the part of Luxembourg to introduce, and with great success, a limited partnership structure that did not have a legal personality, something the jurisdiction was lacking in the past. Through this means, Luxembourg has been able to attract investment from jurisdictions that had previously been deterred by the absence of a structure treated as transparent by their domestic tax authorities by virtue of the importance of a lack of legal personality. Interestingly, the US pays much less regard to the concept of legal personality than many other countries. Most US transparent structures possess a legal personality and this is not regarded as an impediment to transparency either domestically or internationally.

Most jurisdictions, especially those in Northern Europe, adopt some kind of 'similarity' approach so that, broadly speaking, if an entity is regarded domestically as transparent then similar, overseas entities will be accorded similar treatment. This is the system adopted in such countries as Germany, the UK, the Netherlands and Sweden. Even the Belgian approach described above is a variation on this concept of similarity since, in Belgium, legal personality is typically decisive in determining whether an entity is transparent or not.

In Germany, case law in the *Venezuela case of 1930*[5] and modified since has established the *Typenvergleich* principle of categorising foreign entities. This focuses on four key areas:

1. Whether the members have personal liability.
2. Whether there is an entity legally separate from the members.
3. Whether management is centralised and may include non-members.
4. Whether there is a requirement to preserve capital.

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5 RFH vom 12 2 1930.

In the UK, HMRC has published a list of entities that it has reviewed for UK tax purposes. Entities are classified as either transparent or opaque and the list is available online in the International Manual (INTM 180030). Although it is stated that the status will not necessarily apply to each and every overseas entity of the same type, it is regarded as highly persuasive and a useful guide.

In terms of black letter law, UK statute does not address the issue and, instead, the case of *Memec plc v IRC*[6] established the criteria largely derived from earlier case law such as *Dreyfus v IRC*[7] and *Ryall v The Du Bois Company Ltd*.[8]

- Does the entity have a legal existence separate from its members/owners? A separate existence points towards an entity being opaque.
- Does the entity have share capital (or something else that serves the same function as share capital)? Share capital or a related equivalent means an entity tends towards opacity.
- Is the business carried on by the entity or its members? A business carried on by its members is much more likely to be transparent than one in which business is carried out by the entity itself.
- Are the members/owners entitled to profits following a decision by the entity or its members to make a distribution after the period in which the profits have arisen? If the members are entitled to profits as they arise, this will indicate that the entity is transparent. The entity's constitutional documents should make it clear who owns the profits from the time they arise – if profit shares are not determined until the end of the accounting period, this will indicate that the entity is opaque. Entitlement to drawings on account of profit may indicate that the profits belong to the members as they arise.[9]
- Is the entity responsible for debts incurred as a result of carrying on the business? If the entity is responsible for debts, this will indicate that the entity is opaque. However, many limited liability entities are transparent and this factor is not by itself conclusive.
- Are the assets used for carrying on the business owned by the entity or by its members? If the entity owns the assets in its own name, this will indicate that the entity is opaque. In most cases, this factor is linked to the ability of the entity to contract and carry on business in its own name, and having a right to drawings on account of profit may indicate that the profits belong to the members with such rights as they arise.

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6 [1998] STC 754.

7 (1929) 14 TC 560.

8 (1933) 18 TC 431.

9 See *Anson v Revenue and Customs Commissioners* [2013] EWCA Civ 63 discussed below.

Recent case law discussed below[10] has brought into question the universal application of Memec in relation to the question of whether an entity is transparent or opaque. It may now be that the value of Memec lies primarily in determining whether or not an entity can be treated as a partnership for UK tax purposes. However, in the light of the Anson case discussed below, the entity's constitutional documents and governing law will also need to be considered. This is because Anson embraced the possibility of an entity having a corporate form but likewise being fiscally transparent.

Like HMRC in the UK, the Netherlands tax authority publishes a list showing the presumptive tax classification of selected foreign entities. The Netherlands bases this list on a four-factor test, but the list is not considered final or definitive. Under Dutch rules, an entity is generally considered non-transparent if it possesses at least three out of four indicative factors, which are:

- whether the entity can hold legal title to the assets of the business (legal personality);
- limited liability;
- free transferability; and
- whether capital is divided into shares.

As can be seen, the Netherlands approach places more emphasis than most on the property rights of those involved in the business. The rules were supplemented in a 2006 case, which held that a US LLC was opaque.[11] Following this case, the Netherlands tax authority adopted a special rule pursuant to which an entity will be treated as opaque if:

- it owns its own assets;
- it confers limited liability on all of its members; and
- the business was not carried on at the risk and account of the members.

Judging by the above criteria it would seem likely that a UK LLP would similarly be regarded as opaque by the Dutch authorities.

Countries are not always consistent in their approach. In Canada, it is generally the case that, in a similar manner to Belgium, an overseas entity is regarded as being opaque if it has a legal personality. However, in 2000, a Canadian government official discovered that a general partnership, formed under Delaware's revised version of the relevant uniform legislation, possessed legal personality. In July of 2000, Canada announced that Delaware general partnerships would henceforth be treated as corporations, with the result that, because partnerships do not pay taxes at the entity level, treaty benefits would be denied. Predictably, uproar ensued. It was pointed out that

10 *Anson v Commissioners for HM Revenue & Customs* [2015] UKSC 44

11 Supreme Court, 2 June 2006, no 40919, BNB 2006/288.

all US partnerships, regardless of the state in which they were formed and regardless of whether they were general or limited partnerships, possessed legal personality in the sense 'discovered' by Canada in 2000. And that this had been true long before the 1980 tax treaty between the United States and Canada was signed.

Following this incident, Canada relented. In November of 2000, it was announced that henceforth Canada would not apply the legal personality criterion to partnerships formed under US uniform partnership laws. It took ten years for a new protocol to the treaty to be approved, extending the same courtesy to US limited liability companies. Ironically, after the new protocol was adopted, the Tax Court of Canada decided, at least on the facts before it, that the protocol wasn't needed. In *TD Securities (USA) LLC v Her Majesty the Queen*,[12] the court held that a US LLC must be considered to be a resident of the US for purposes of the treaty. In so deciding, the court respected the LLC as a separate legal entity having a legal personality distinct from its members. It thus tested residence for treaty purposes at the entity level. However, it overcame the objection that the LLC was not taxable at the entity level, and therefore could not qualify as a resident under the treaty, by holding that the LLC 'must be considered to be liable to tax in the US by virtue of all of its income being fully and comprehensively taxed under the US Code albeit at the member level'. In essence, the court determined that having separate legal personality was irrelevant to the tax classification of an LLC, albeit only for the limited purposes of the treaty between the US and Canada.

Treaty eligibility?

The issue between the US and Canada highlights the issues that can be raised in relation to treaties when transparent vehicles are involved. It might be considered that the positive side of an entity being regarded as opaque for tax purposes is the inference that it might then be eligible for treaty benefits, if there is a treaty between its jurisdiction of organisation and that regarding it as opaque. Frequently, however, this is not the case.

A typical treaty accords benefits to those 'resident' in one or other of the jurisdictions involved. However, residence is defined as those liable to tax in the jurisdiction in which they are seeking to be regarded as resident. Thus, the domestic tax position is the one to consider, whatever the position being taken by the treaty partner jurisdiction. Accordingly, a partnership regarded domestically as transparent is not eligible for treaty benefits on the basis that it is not 'liable to tax' in the jurisdiction in which it is organised.

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12 2010 TCC 186 (8 April 2010).

The Canadian case referred to above in which it was held that an LLC was liable to tax on the basis that US tax was imposed on all its income being taxed at the member level may not always be applicable. For example, an English investment partnership may have membership comprised entirely of UK nationals and, accordingly, would have all its income taxed in the UK. However, partners not resident in the UK would be taxed on non-UK source income. Thus, if the partnership were accorded treaty benefits this could result in non-residents effectively taking advantage of this.

Some newer treaties deal with specific entities by appropriate language in the relevant treaty. However, the general position is that the absence of liability to tax precludes most fiscally transparent entities from accessing treaty benefits. Generally speaking, however, these can be claimed at the partner or member level. Thus, for example, a UK partner in a UK partnership can claim UK treaty benefits and a US partner in a UK partnership can claim US treaty benefits. This can result in a much more cumbersome reclaim procedure, with each separate partner being required to make their own claim. However, some jurisdictions are willing to accord treaty benefits to fiscally transparent vehicles that can demonstrate they comprise only treaty eligible partners. This can be demonstrated in the recent OECD work referred to below.

Consequences of mismatch

The potential for significant complexity in the area of transparency is well illustrated in the case of *Anson v Revenue and Customs Commissioners*[13] referred to above.

Mr Anson was a member of a Delaware LLC, which carried on business in the US. Since a Delaware LLC is transparent for US fiscal purposes, he was taxed in the US on his share of the profits. The question was whether he could claim credit for that tax against the UK income tax on his profits under the UK/US double tax treaty. That depended upon whether it could be said that Mr Anson's source of income was the same for US and UK tax purposes. In the case of the US, the source was the trade of the LLC. The question was, therefore, whether this trade was also the source of his income for UK tax purposes or whether the source was the LLC agreement. If the latter, he would be no more entitled to credit for the US tax than would be a shareholder in a US company.

The First Tier Tribunal held that Mr Anson was entitled to treaty relief since the profits were derived from the same source. However, the Upper tier Tribunal and the Court of Appeal held that Mr Anson's source was his

13 [2013] EWCA Civ 63.

interest in the LLC rather than its trade. The Court of Appeal focused on whether he had a right to the profits of the LLC at the time when they were created or whether he was merely entitled to distributions made out of them. In coming to the latter conclusion, it placed reliance on the fact that the cash generated by the profits belonged to the LLC until it was distributed and that it was the LLC and not its members that carried on the business. The latter point distinguished the LLC from Scottish partnerships where, although the entity has a legal personality separate from its owners, the partners are regarded as carrying on the business itself in common with each other.

The Supreme Court overruled the Court of Appeal decision, holding, in July 2015, that, as the First Tier Tribunal had originally ruled, the profits upon which Mr Anson was taxed in the US were the same as those the UK was seeking to tax. The Supreme Court decision placed far less emphasis on the distinction between a partnership and a corporation and far more on the aims of the treaty between the two countries in terms of avoiding double taxation and the application of local (Delaware) law and the LLC's governing documents in determining the source of the taxable income. The Court of Appeal's decision resulted in a mismatch from Mr Anson's perspective is that he was taxed at an overall effective rate of 67 per cent. He had previously been taxed at a rate of 45 per cent in the US and, with no credit given for that payment, was subsequently taxed at a rate of 22 per cent (40 per cent of the remaining 55 per cent after deducting US tax) in the UK. This was clearly at odds with the treaty aims of the UK and the US and at odds with the law under which the LLC was formed and the Supreme Court considered these factors more carefully.

The Anson decision does, however, illustrate the continuing complexities of the transparent/opaque distinction. Although it found the LLC to be fiscally transparent, the Supreme Court judgment was far from regarding it as a partnership. This gives rise to some uncertainty as to the wider implications of the judgment. If the LLC is a kind of corporate, yet transparent vehicle, how will it be treated for other tax purposes such a grouping and permanent establishment and for certain other areas of law. Equally, is the decision fact specific and how far can it really extend to other LLCs? How far is Memec still applicable? These questions remain despite final clarity for Mr. Anson personally. It is hoped that further guidance from HMRC will clarify their position on these points.

Common reporting

The introduction of the United States Foreign Accounts Tax Compliance Act in 2010 (FATCA) paved the way for a global standard of common reporting

in which certain financial entities are obliged to report the details of the residence of their account holders to their tax authorities with a view to information exchange.

It is beyond the scope of this article to analyse the details of FATCA and the common reporting standard but country of 'residence' of certain fiscally transparent entities could result in issues in this area. Compliance with many aspects of the legislation, including reporting, involves, not surprisingly, determining an entity's 'residence'.

Transparent entities without legal personality such as English general or limited partnerships are difficult to classify in terms of residence because, in this context, the term 'partnership' describes the relationship between the parties rather than an entity that can adopt a residence. In the case of structures that do have legal personality and are thus likely to require registration in a certain jurisdiction, the question may be more straightforward. However, there is no universally accepted concept of where a partnership or similar entity is 'resident' for these purposes. This could result in a partnership being regarded as resident in more than one jurisdiction or otherwise having difficulty in ascertaining the correct form of compliance.

Following the enactment of FATCA, both the UK and the Cayman Islands entered into intergovernmental agreements (IGAs) with the US governments. These agreements, and many others of the same type, stated that entities resident in the jurisdictions involved, which, under FATCA, would have to report certain information to the Internal Revenue Service (IRS), could report instead to their own tax authorities who would relay the details to the IRS themselves. Thus, partnerships resident in the UK would report to HMRC and those in Cayman would report to the Cayman authorities. This system is likely to become the standard as global reporting develops – each resident to which the legislation applies will report the identities and jurisdictions of their account holders to their local tax authorities who will share the information with overseas authorities.

However, an issue arose in relation to partnerships. Under the UK legislation and guidance implementing the IGA, a partnership was regarded as 'resident' where it was managed and controlled. Thus, a limited partnership organised in England but managed by a Cayman general partner was not regarded as being UK resident. Under the UK definition of residence such partnership was resident in Cayman. The Cayman Islands, however, adopted a definition of residence in relation to partnerships that was based on jurisdiction of organisation: thus, a partnership organised in England but managed by a Cayman general partner. Accordingly, the partnership concerned was not resident in either IGA jurisdiction and was thus ineligible to use an IGA and would, presumably, have had to comply with FATCA itself

directly and report to the IRS. In the event, the Cayman Islands addressed this issue by a change in its guidance but it cannot be assumed that this will be the only time a similar mismatch arises.

Conversely, it is conceivable that a partnership could be regarded as resident in more than one jurisdiction, which might create double reporting issues. This could be equally or more problematic. It should be noted that common reporting is still in its early stages and it may be that jurisdictions resolve these issues as they arise – this was certainly the case in the example cited above in relation to the UK and the Cayman Islands.

Base erosion and profit shifting (BEPS)

The OECD's BEPS project was initially targeted at multinational groups and did not consider fiscally transparent structures, especially those formed for collective investment reasons, in great detail. BEPS is comprised of several 'action points', but that of most concern in this area is the treaty abuse action.

In relation to treaty abuse, the key concern has been the proposal to amend tax treaties by the inclusion both of a 'principal purpose test' (PPT) and a limitation of benefits ('LOB') clause. The PPT would provide that relief would be denied for entities which are established principally for tax reasons and the LOB test would limit relief to entities beneficially owned by those entitled to relief directly. If a partnership owned a subsidiary investment holding vehicle ultimately indirectly owned by the partners who may be geographically widespread, the choice of jurisdiction for the vehicle will often be tax-driven (at least in part). Hence, the PPT and LOB clauses may prevent such subsidiary vehicles from benefitting from the relevant treaty or treaties.

The most recent OECD publication suggests a 'simplified' LOB clause, which would address the most obvious cases of treaty shopping, with other cases being dealt with under the PPT. The document sets out proposals to deal with the issues identified in earlier discussion drafts, including the application of a LOB and treaty entitlement for collective investment vehicles ('CIVS') and non-CIV funds, particularly to counter the concern that non-CIVs may be used to provide treaty benefits to investors that are not themselves entitled to treaty benefits and that investors may defer recognition of income on which treaty benefits have been granted. Possibilities include adding a specific provision on non-CIVs in the LOB rule and adding one or more examples on non-CIVs to the Commentary on the PPT rule. However, the issues remain far from resolved and the actual impact of this

to transparent structures will depend largely upon the extent to which these recommended clauses are adopted.

The future

The continued globalisation of business generally and the increased burdens imposed by such measures as common reporting have brought into focus the issues arising with transparent entities and how they are regarded internationally. Most unsatisfactory is the absence of a consistent position as to whether an entity is transparent or opaque by default. As the *Anson* case demonstrated, the complexity in this area can be considerable. Resolving this may prove difficult and it might be that other jurisdictions could benefit from adopting a US-style election system.

Fiscal transparency will always be an attractive option for some businesses but it must be balanced against other considerations. As more and more countries introduce vehicles designed to accommodate this balancing requirement, it can be anticipated that the number and international complexity of such entities will increase.

Regulation of Parallel Imports in the Eurasian Economic Union: Any Competition Tends to Monopoly

Alexander Bondar*

On 22 April 2015 Russian Prime Minister Dmitry Medvedev approved the legalisation of parallel imports for a number of goods. Medvedev said that the transition to the international principle of exhaustion of rights could be 'an important anti-crisis measure' and continued:

> '[It] will result in the legalization of so-called parallel import and make it possible to import goods into our [Russian Federation] country under the relevant trade mark, by any importer, not only the owner of the trademark or its official distributor. Therefore, the goods can be purchased in third countries, where it is cheaper to import them into our territory without the consent of the manufacturer or the right holder. Naturally, this could affect the prices towards their reduction…'.[1]

Introduction

The principle of exhaustion of trademark rights (right of first sale of the goods) is implemented in order to improve the conditions of competition. According to this principle, after the sale of goods by the rightholder or with its consent the rightholder loses IP rights related control over their resale or any other form of commercial use. The essence of this principle in relation

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1 See 'Medvedev began the legalization of parallel import to reduce prices' *RBK* (5 May 2015) http://top.rbc.ru/economics/05/05/2015/554887b39a7947b5d59b38fc.

to trademarks is traditionally described by national laws. It is also stated in clause 16 of Annex No 26 to the Treaty on the Eurasian Economic Union, which entered into force on 1 January 2015.

The international principle of exhaustion of rights is a principle under which the exclusive right of the owner is considered to be exhausted once the product has been sold to the rightholder or with its consent in any country (eg, this rule is stated in article 14 of the Law of Armenia On Trademarks, Service Marks and Appellations of Origin No 3P-41, dated 31 March 2000).

Under the national principle of exhaustion of rights it is not an infringement of the exclusive right to trademark to use the trademark in relation to the sale of goods that have been lawfully placed on the market in the territory of the state (this rule is still stated in clause 1487 of the Civil Code of the Russian Federation).

The owner of a trademark has exclusive right to use a trademark belonging to it at its discretion, and to prohibit its use by other persons in the territory where the trademark is legally protected. The principle of exhaustion of rights is a necessary tool to balance the interests of the trademark owner and the needs of the market and is based on the principle of free movement of goods, which is important for the functioning of any market.

On 1 January 2015 the Treaty on the Eurasian Economic Union (EAEU) became effective. The Treaty confirms the creation of an economic union that provides for free movement of goods, services, capital and labour and pursues a coordinated, harmonised and single policy in the sectors determined by the document and international agreements within the Union.

Under paragraph 16 of Part V of Appendix No 26 (Protocol on the security and protection of intellectual property) in the Member States in relation to the principle of exhaustion of the exclusive right to the trademark, the trademark of the Union is applicable. In accordance with that principle the use of the trademark of the Union in relation to goods that have been lawfully sold in the territory of any of the Member States by the rightholder of the trademark of the Union or any other person with its consent is not an infringement of the exclusive right to the trademark of the union. This principle is called the “regional principle of exhaustion”. As a result, after legally entering into the territory of the Russian Federation, Kazakhstan, Belarus, Armenia or Kyrgyzstan, the exclusive rights of the owner of the trademark no longer apply, and further such goods can be resold freely inside the EAEU. In this context, the Treaty on the EAEU is pre-emptive to the Agreement on Unified Principles of Regulation in the Spheres of Intellectual Property Rights Protection that was in effect before.

Although under Article 89 of the Treaty on the EAEU Member States shall cooperate in the field of protection and enforcement of intellectual property, the regional principle of exhaustion of rights is not working in full. This is both because of the complexity of the implementation of international treaties, caused by the need to incorporate the rules of the international treaty into the national law of the states that are parties to the EAEU, as well as due to the lack of consistent criteria and approaches in application of national legislation.

The differences in the interpretation of the principle of exhaustion of right raise the phenomenon of parallel imports. A parallel import is an import into the country of products made by the manufacturer and marked by its trademark but imported without its consent. A parallel import is an import from the country of origin of goods that were legally produced and legally sold in the country from which they were subsequently exported from the country of origin.

Supporters of parallel imports raise the following arguments:

- parallel imports as opposed to counterfeit goods generate income for manufacturers;[2]
- the ban on parallel imports creates conditions for violations of antitrust laws;
- legalisation of parallel imports will lead to a reduction in the retail prices of imported goods and an increase in the volume of taxes and duties on import that is beneficial both to the state and to consumers.

Opponents of parallel imports raise the following arguments:

- legalisation of parallel imports would not guarantee price reduction;
- the uncontrolled import of goods will entail the failure of investment projects for the production of similar goods;
- legalisation of parallel imports would lead to the risk of increase of counterfeit goods as manufacturers will not be able to control the delivery and storage of goods.[3]

In the opinion of the Eurasian Economic Commission, Belarus, Ukraine and Kazakhstan should purchase goods at the lowest prices. Parallel imports legislation has been proposed in order to reduce or even remove the negative impact of subjective factors on the formation of prices for imported goods. Manufacturers of goods will have the right to open their production in the country where the goods are imported. Thus they will become local producers, to which state legislation provides full protection of trademark rights.

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2 V I Lysakov, 'Parallel import – a thermometer of the free market. Antitrust activity of a single economic space' (The Eurasian Economic Commission, July–December 2014, No 4), 8–13.

3 See 'Counterfeit goods will be more. Will parallel import lead to cheaper medicines and spare parts?' *TUT.BY* (8 May 2015) http://news.tut.by/economics/447115.html.

In light of current changes and debates it is still the court practice that provides the application of law in relation to parallel imports in the EAEU. And subsequent court practice cannot be characterised as consistent.

Treatment of parallel imports and principle of exhaustion of rights in the Republic of Belarus

The legislation of the Republic of Belarus, namely Article 20 of the Law of the Republic of Belarus No 2181-XII of 5 February 1993, on Trademarks and Service Marks, contains the national rule implementing the principle of exhaustion of rights.

According to a decision of the Judicial Board for Intellectual Property of the Supreme Court of the Republic of Belarus dated 15 April 2013 the importation of goods lawfully introduced into civilian turnover in the Russian Federation by the trademark owner, or with its consent, and lawfully purchased in the Russian Federation and then imported into the territory of the Republic of Belarus, is not an infringement of the exclusive right of the trademark owner to a trademark according to the regional principle of exhaustion of rights entered into force as of 1 January 2013.[4]

Closed Joint Stock Company (CJSC) 'TT' (a resident of the Russian Federation) filed a lawsuit against limited liability company (LLC) 'M' (resident of the Republic of Belarus), requesting the termination of acts violating its right to the trademark 'B', by way of prohibiting the importation of, offer for sale, sale, or storage for sale, of goods marked with such trademarks in the Republic of Belarus.

In support of its claims the claimant stated that it was the owner of trademark 'B', which enjoys legal protection of which in the Republic of Belarus is provided in relation to goods falling under Class 03 of the International Classification of Goods and Services (ICGS): creams and gels for the face, body, arms and legs.

According to the facts of the case, since 2011 respondent 'M' imported into the Republic of Belarus from the territory of Russian Federation, as well as offered for sale, stores to sell goods that carry the trademark 'B' in respect of which the manufacturer – the claimant 'TT' – limits its spread in the Russian Federation. 'TT' argued that under these circumstances, such products are placed on the market of the Republic of Belarus illegally, and, therefore, must be considered counterfeit.

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4 Based on an extract taken from the decision of the Judicial Board for Intellectual Property of the Supreme Court of the Republic of Belarus dated 15 April 2013 (*TT (Russian Federation) v M (Republic of Belarus)*). (SPS 'ConsultantPlus: Belarus' [Electronic resource] – Minsk, 2013)

By a decision of the Judicial Board for Intellectual Property of the Supreme Court of the Republic of Belarus dated 15 April 2013 rejected the claim of 'TT' based on the following reasoning:

In accordance with Article 20 of the Law of the Republic of Belarus No 2181-XII of 5 February 1993 on Trademarks and Service Marks it is not an infringement of the exclusive trademark right to use that trademark in relation to goods lawfully introduced into civilian turnover in the territory of the States Parties to the Agreement on the Unified Principles of Regulation in the Spheres of Intellectual Property Rights Protection, adopted on 9 December 2010 at Moscow (entered into force on 1 January 2012)[5] directly by the trademark owner or other person with its consent.

After evaluating the evidence presented to the court in its entirety, the panel of judges rejected the claims of 'TT' on the following grounds: on the basis of Article 13 of the said Agreement, the use of the trademark in relation to goods that have been lawfully placed on the market in the territories of the parties by the rightholder or others with its consent is not a violation of the exclusive rights to the trademark.

Throughout this agreement, the national principle of exhaustion of the exclusive right to the trademark was amended by the Agreement with effect from 1 January 2012 by the regional principle, which limits to some extent the exclusive rights of the trademark owner, which it would otherwise enjoy under national law.

The Judicial Board established that, since May 2011, the respondent imported into the territory of the Republic of Belarus the original goods with the designation '911' and the trademark 'B' that had been legally placed on the market of Russian Federation by the manufacturer of the goods and the rightholder of the trademark – 'TT'.

According to the materials of the case the goods marked with the trademark 'B' were imported by the respondent 'M' into the Republic of Belarus under a contract with a business entity of the Russian Federation – LLC 'S'. Subsequently, these goods were introduced on a wholesale basis by the respondent in a civil turnover of the Republic of Belarus to Belarusian companies. Importantly, the respondent did not take any steps to change the properties, quality or packaging of the imported goods.

The panel of judges found that the trademark owner, through the direct and legitimate introduction of goods bearing the trademark 'B' in the civil turnover in the Russian Federation, which was a party to the Agreement on Unified Principles of Regulation in the Spheres of Intellectual Property Rights Protection, adopted on 9 December 2010 at Moscow (entered into force on 1 January 2012) had realised the exclusive right to distribute

5 This became inoperative since 1 January 2015 as the Treaty on the EAEU entered into force.

at the first sale of the goods in the Russian Federation, and therefore exhausted it. With respect to such goods 'TT', the judges held, could not prohibit the import and its subsequent introduction into civil circulation of Belarus.

At the same time the opposite approach was taken in another case considered by the court in the Republic of Belarus.[6]

The company, which was a producer of beer having a world-famous brand (the claimant), and owned the relevant trademark, filed a lawsuit against a Belarusian company (the respondent), which had imported the relevant goods into the territory of the Republic of Belarus. The trademark owner had not expressed its consent or entered into a contract that would have allowed the respondent to carry out the import, distribution and/or consumption in the territory of the Republic of Belarus or other countries. The goods imported by the respondent were designated by a trademark identical to the trademark of the claimant.

In accordance with the Law of the Republic of Belarus No 2181-XII of 5 February 1993, on Trademarks and Service Marks, the trademark owner has the exclusive right to use the trademark and dispose of it, as well as prohibit the use of it by others. Nobody has the right without the permission of the owner to use the protected trademark in the territory of the Republic of Belarus. Violation of the rights of the trademark owner is recognised and unauthorised importation of the goods indicated by the trademark or designation similar to the point of confusion is prohibited.

According to Article 13 of the Agreement on Unified Principles of Regulation in the Spheres of Intellectual Property Rights Protection and Article 20 of the Law of the Republic of Belarus No 2181-XII of 5 February 1993, on Trademarks and Service Marks when a trademark is used without the consent of the trademark owner, it is a violation of the exclusive right of the trademark owner to use its trademark in relation to goods that have entered into civil turnover in the territory of the countries that are participants of the Agreement.

The court held that changing the designation of goods protected by the trademark is an independent way of using the trademark that violated the exclusive rights of the claimant. Therefore the court granted the trademark owner's claim. The trademark owner which has received legal protection against the actions of the parallel importer.

The court analysed and followed the legal and economic arguments of a producer: it considered that parallel imports had a negative economic impact

6 *Producer of Beer v Distributor of Beer*. An extract of decision has been taken from the article 'The impact of parallel imports on the development of competition', A.Bondar, *Industrial and Commercial Law*, 28/10/2014, N 11.

as they infringed the rights of consumers to obtain reliable information about the properties of the goods. This was due to the fact that the parallel importer did not provide a complete translation of the information contained on the label of goods and did not participate in the promotions of the relevant goods. The trademark owner may suffer reputational harm from the incompetent actions of the parallel importer when a parallel importer fails to comply with all the necessary rules and regulations, which are followed by the rightholder and authorised distributors.

Treatment of parallel imports and principle of exhaustion of rights in the Republic of Kazakhstan

The recent decision of the appellate judicial board on civil and administrative cases of the Almaty City Court of 12 November 2014 No 2a-7865-2014 showed that the courts of Kazakhstan are inclined to allow parallel imports in the territory of the state. The facts of the case were as follows.[7]

The specialised inter-district economic court of Almaty dated 4 August 2014, found in favour of Nissan Jidosa Kabushki Kaisha and prohibited the limited liability partnership (LLP) Carlux Company from any use of the trademark in respect of Nissan cars as follows:

- import of Nissan cars carrying the Nissan trademark;
- storage of such cars;
- offering for sale of such cars;
- sale of such cars;
- use in advertising and more.

The respondent appealed the decision of the court of first instance and pointed out that the court did not take into account that Carlux Company had acquired cars bearing the 'NISSAN' trademark at the Kazakhstan legal entity 'Alem Prom Business' LLP in the territory of the Customs Union, which officially brought them to the territory of the Republic of Kazakhstan, and, therefore, did not violate the exclusive right to the trademark 'NISSAN'. This original product was legally sold in the territory of the Customs Union by the owner of the trademark, and with its consent, so that the goods can be transported freely within the Customs Union and resold.

Carlux Company could thus legally sell the cars bearing the 'NISSAN' trademark on the territory of the Republic of Kazakhstan, and is free to sell

7 *Nissan v LLP Carlux Company*. An extract of the decision has been taken from the article 'The second victory of independent business against international corporations. Nissan lost the case in the proceedings against the parallel importer' http://snabkaz.kz/page8.php?SessionID=ad19c453052956c1bb5, Date of access: 04.08.2015.

them and use the trademark in advertising to promote products purchased from an authorised dealer of the rightholder in the Customs Union. The court held that this did not apply where the trademark owner or authorised person first placed the relevant goods onto the market in the Russian Federation and Republic of Belarus, but also to cases in which these goods were previously lawfully imported into these countries by the rightholder or an authorised person.

On 11 December 2014, the Almaty City Court in case No 2-6492/2014 considered the appeal against this decision, cancelled the decision of the specialised inter-district economic court of Almaty dated 4 August 2014 on the grounds that it violated substantive and procedural law, and required the case to be reconsidered.

Treatment of parallel imports and principle of exhaustion of rights in the Russian Federation

Practice shows that the number of disputes over the use and protection of intellectual property rights in the context of bilateral trade between the countries of the Customs Union is growing. The absence of customs borders between the Russian Federation, the Republic of Belarus and Kazakhstan guarantees respect for the principle of free trade within this region. But the intellectual and legal boundaries between the states of the EAEU still exist, and the resolution of legal conflicts complicates the question of how far to protect the rights of the holders of intellectual property. Building a harmonious system of legal regulation in the field of intellectual property protection depends on a common understanding of key terms, which include the concept of 'parallel imports' and the principle of 'exhaustion of rights'.

In striking contrast to the provisions of legislation of the Republic of Belarus Article 1487 of the Civil Code of the Russian Federation states that it is not a violation of the exclusive rights to the trademark use of the trademark by other persons in relation to goods that have been put into civil turnover in the territory of the Russian Federation by the rightholder or with its consent.

According to the Resolution of the Federal Arbitration Court of the Moscow District dated 21 March 2011 N KG-A40/1705-11 in case N A40-60322/10-12-360 Heineken Czech Republic, joint stock company brought action against 'ElitVoda Ru' LLC ('the respondent') to ban them from taking any actions on the introduction of the goods marked with trademark 'KRUSOVICE' into civil turnover in the territory of the Russian Federation without the consent of the Company.[8]

8 *'Heineken Ceska republika' (Czech Republic) v LLC 'ElitVoda Ru'* (Russian Federation), Resolution of the Federal Arbitration Court of the Moscow District dated 21 March 2011 N KG-A40/1705-11 in case N A40-60322/10-12-360 SPS 'ConsultantPlus: Russian Federation' [Electronic resource] – Moscow, 2011.

The respondent imported beer, marked with the trademark applicable in the territory of the Russian Federation. The claimant pointed out that while the beer was the original product, produced by it, it did not give its permission for the beer to be imported into the territory of the Russian Federation.

The court granted the claim in part, the other part was directed for a new trial because the court had failed to determine the final amount of compensation.

The court held that the respondent had not presented to the court sufficient evidence of the introduction by the claimant of the goods into civil turnover in the territory of the Russian Federation, or that such rights were granted to third parties. Therefore, the court held that the respondent had violated the exclusive right of the claimant in relation to the trademark 'KRUSOVICE'.

There is debate about whether the products produced by the manufacturer, marked and released for commercial sale, but imported without the permission of the trademark owner, are counterfeit. The answer to this question is important in the application of the judicial protection of grey imports. The problem is that the term 'counterfeit goods' is not a legally well-defined term and may be interpreted in different ways.

In the Russian Federation, the CJSC judicially banned the LLC from taking any action (including import, possession for the purpose of selling, offering for sale, sale) for the introduction into civil turnover in the territory of the Russian Federation the goods bearing the trademarks of the CJSC, without its consent as the rightholder.[9]

The court of the Russian Federation found that the CJSC owned the exclusive right to trademarks S. This right was recognised and was introduced in the Customs Register of intellectual property and protected in the territory of the Russian Federation. The court relied on the fact that:

- The LLC had imported into the territory of the Russian Federation goods marked by the trademark S.
- The CJSC did not give its consent to the LLC to import these goods.
- The LLC, which was the declarant and the recipient of the goods that were imported into the territory of the Russian Federation, did not provide evidence to the court of the consent of the rightholder to introduce into civil turnover in the territory of the Russian Federation the imported goods.

According to Article 1484 of the Civil Code of the Russian Federation, import into the territory of the Russian Federation of goods marked with a trademark in order to introduce them into civil turnover in the designated territory, as well as the storage of these goods for the purpose of sale, offering for sale and sale, are independent methods of use of the trademark.

9 *Sanpelegrino SPA v LLC 'ElitVoda Ru'*, An extract of the decision has been taken from the article, 'The principle of exhaustion of the exclusive rights to industrial property and anti-competitive practices, O. Gorodov, *Competition Law*, 2013. N 2. pp 7 - 12.

In the absence of a consent to use the trademarks in this way, the court found the goods imported by the LLC were counterfeit, ie, they violated the exclusive rights of the owner (Articles 1252 and 1515 of the Civil Code of the Russian Federation).

Conclusion

According to information released in September 2014 the Council of the EAEU Commission has established a working group to develop proposals for the further implementation of the principle of exhaustion of the exclusive rights to intellectual property. The working group considered various options for the development of the situation:

- the proposal of the Federal Anti-monopoly Service of the Russian Federation of the appropriateness of establishing a priority of the international principle of exhaustion of rights in respect of spare parts, pharmaceuticals, perfumes and cosmetics with a derogation in respect of investors, owners, and localised production in the territories of the Member States of the EAEU;
- strengthening the role of antitrust authorities, providing them with the powers to authorise the parallel import of certain goods in the event that it is in the public interest;
- the removal of customs control of parallel imports of goods and others.

According to the Minister on Economy and Financial Policy of the Eurasian Economic Commission Timur Muratovich Suleimenov:

> 'Obviously, the best option would be the introduction of a more flexible hybrid principle of exhaustion of the exclusive right. That is, the default would be for one of the basic principles (regional or international) and a number of product goods may be granted exemptions. The question of which principle will operate by default is the key issue. That is necessary to solve by the Working Group in the first place and only then work out embodiments of the chosen approach, both in law and in practice.'[10]

We believe that the subsequent regulations and court practice of the EAEU will solve the problem of parallel imports within the next five years through reasonable legislative compromise between the state wishing to provide consumers with quality products at reasonable prices, and large manufacturers, ready to observe the rules of fair competition.

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10 See Interview of Member of the Board – Minister on Economy and Financial Policy of the Eurasian Economic Commission Timur Muratovich Suleimenov to Russian newswire TASS on the legalisation of parallel imports (Eurasian Economic Commission, 16 February 2015) www.eurasiancommission.org/en/nae/news/Pages/16-02-2015-1.aspx.

Data Security and the Legal Profession: Risks, Unique Challenges and Practical Considerations

Anurag Bana and David Hertzberg*

Introduction

Data security is the area of information security that deals with the protection of digital assets.[1] It is an increasingly prominent and important area of risk for the global legal profession. This is due to the speed with which technology has developed, and is continuing to develop. The explosion of electronic communications and electronic storage and indexing of information, and new and easier ways to access that information, has ushered in a new suite of data security issues. Compared to other businesses, law firms are perceived to have particular data security vulnerabilities. In-house counsel are also considered to be critically lacking in data security expertise. Lawyers in all jurisdictions and practice settings need greater engagement with the issue of data security to protect the interests of their clients, their firm and the general public, and to discharge their professional ethical obligations.

There is evidence that the scale of the data security challenge is being recognised in the legal profession. In one survey of top UK law firms, the percentage of respondent law firms citing information security as their top concern doubled from 23 per cent in 2012 to 46 per cent in 2014.[2] For management in the surveyed law firms, information security was the most frequently mentioned risk management priority.

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1 Jill D Rhodes and Vincent I Polley (eds), *The ABA Cybersecurity Handbook: A Resource for Attorneys, Law Firms, and Business Professionals* (ABA Publishing 2013), 27.

2 Law Firm Risk Roundtable, *2014 Law Firm Risk Survey: UK Edition.*

There is also evidence that the wider legal profession has less awareness of the data security issue. Respondents to a recent online Bloomberg BNA poll ranked 'hackers and data breaches' fourth out of five enumerated threats to law firms, with only 11 per cent of the vote.[3]

It is crucial that the legal profession understands and addresses data security risk. This means that data security cannot be written off as an IT issue.[4] Rather, it is a risk that requires attention and engagement at every level of a law firm's business. It should be seen as a senior management responsibility: data security is an area where firms need to be proactive, and that requires leadership from management. A proactive approach is equally important for in-house counsel and lawyers in small firms.

The second part of this article gives an overview of the data security risk for law firms and in-house counsel. The nature and scale of the data security risk mean that it must be a top priority for the legal profession. The next section examines the unique considerations and challenges that apply to lawyers as professionals. The intersection between data security and legal professional ethics necessitates a sector-orientated approach to data security risk. The fourth section elaborates on the practical considerations associated with particular technologies and initial steps to address the data security issue. It concludes that the global legal profession needs to act collectively to raise awareness and provide education, training and other resources to address data security risk.

Data security: a key area of risk for all members of the global legal profession

The nature of the risk

Assessing the scope of the data security challenge is inherently difficult. It is unclear how many data security breaches have occurred, who has orchestrated or benefited from these breaches, what information was stolen, how valuable that information was, how to quantify reputational damage and operational disruption, and so on.[5] The estimates of data security consultants and other stakeholders may need to be taken with a pinch of salt.[6]

However, there can be no doubt that data security is a pressing issue that will increasingly be a priority for law firms and businesses generally. A report

3 Ryan Schlunz, 'It's Time to Get Serious About Law Firm Cybersecurity' *Bloomberg BNA* (7 April 2015) https://bol.bna.com/its-time-to-get-serious-about-law-firm-cybersecurity/.

4 Solicitors Regulation Authority, *Spiders in the web: The risks of online crime to legal business* (March 2014), 3.

5 Michael McNerney and Emilian Papadopoulos, 'Hacker's Delight: Law Firm Risk and Liability in the Cyber Age' (2012) 62 American University Law Review 1243, 1248, 1260.

6 Peter Maass and Megha Rajagopalan, 'Does Cybercrime Really Cost $1 Trillion?' *ProPublica* (1 August 2012) www.propublica.org/article/does-cybercrime-really-cost-1-trillion.

released in May 2015 by market analyst firm Juniper Research predicts that the global cost of data breaches will reach $2.1tn in 2019.[7] By way of comparison, that is roughly the 2015 GDP of India. The same report predicts that the average cost of a single data breach will exceed US$150m by 2020, as businesses increase their connectivity.[8]

The consequences of a law firm data security breach may be severe. Risks include:

- financial loss to the firm's clients, third parties and the firm;
- reputational damage to the firm's clients, third parties and the firm;
- damage to the reputation and standing of the legal profession;
- in some cases, damage to economic infrastructure or threats to national security;
- possible questions of professional misconduct or failure to meet the minimum statutory standards for data protection.

The law firm risk profile

Law firms are perceived to be particularly vulnerable. In March 2015, a leaked memo from Citigroup's cyberintelligence centre warned that law firms are at 'high risk for cyberintrusions' and that bank employees should be aware that digital security at law firms generally remains below the standards for other industries.[9] A 2013 survey found that 80 per cent of partners and IT directors in surveyed law firms believed they were likely to be the subject of a cyberattack, while only 36 per cent believed that their systems could withstand an attack.[10] The survey also found that only 31 per cent of people working in law firms believe that management fully understands the issues around cybersecurity.[11] In the 2015 Cisco Annual Security Report, Cisco ranked law firms as the seventh most vulnerable industry to 'malware encounters'. This is the first time the legal sector has appeared in the top ten.

7 Juniper Research, *The Future of Cybercrime & Security: Financial and Corporate Threats & Mitigation*, cited at 'Cybercrime Will Cost Businesses Over $2 Trillion by 2019' (Juniper Research, 12 May 2015) www.juniperresearch.com/press/press-releases/cybercrime-cost-businesses-over-2trillion?utm_source=gorkanapr&utm_medium=email&utm_campaign=cybercrime15pr1.

8 Samantha Woodhill, 'GCs struggling to mitigate cyber risks' *Australasian Lawyer* (20 May 2015) www.australasianlawyer.com.au/news/gcs-struggling-to-mitigate-cyber-risks-200525.aspx.

9 Matthew Goldstein, 'Citigroup Report Chides Law Firms for Silence on Hackings' *The New York Times* (26 March 2015) www.nytimes.com/2015/03/27/business/dealbook/citigroup-report-chides-law-firms-for-silence-on-hackings.html?_r=0.

10 Anna Reynolds, 'Fears of Cyber Crime Rise As Nearly 80% Believe Their Firm Could Be Hit By Web Hack' *Legal Week* (3 May 2013) www.legalweek.com/legal-week/news/2265292/fear-of-cyber-crime-on-the-rise-as-nearly-80-believe-their-firm-is-likely-to-be-hit-by-web-hackers#.

11 *Ibid.*

Law firms are attractive targets for those who would steal digital assets for two main reasons. First, they hold a high concentration of sensitive and valuable information.[12] Law firms tend to store the most important and valuable client files. It is faster to find these files in a law firm than by searching through all of the information on the client's server.[13] Law firms also offer the potential to access the valuable information of numerous clients at once. Law firms electronically store:

- intellectual property, such as trade secrets or draft patent applications;
- business strategies;
- financial account details;
- inventories of assets;
- litigation strategies;
- IPO or M&A details;
- a wide variety of personally identifiable information and protected health information relating to employees of the law firm, clients, employees of clients or third parties.

In addition, law firms often hold large sums of money in their trust accounts.[14]

The second reason that law firms are attractive targets is that they are considered easier targets. Law firms often have weaker data security than their clients or third parties such as banks. Clients tend to be larger companies with more resources to devote to information security.[15] Economies of scale can assist larger businesses to implement data security measures. Smaller businesses are often more vulnerable. The client might store data on a private cloud, have a larger and better-resourced IT department and hire expensive external data security consultants. For example, in the US the perception is that compared to the Patent and Trademark Office and the businesses that own the intellectual property, the law firms that work with businesses to draft patent applications are an easy target for those who would seek to steal valuable IP.[16] Indeed, law firms have variously been described as the 'low hanging fruit', the 'soft underbelly', the 'Achilles heel' or the 'weakest

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12 Rhodes and Polley (eds), see n 1 above, 127.

13 Ed Finkel, 'Cyberspace Under Siege' *ABA Journal* (1 November 2010) www.abajournal.com/magazine/article/cyberspace_under_siege.

14 Dan Pinnington, 'Cybercrime and law firms: The risks and dangers are real' (2013) 12(4) *LawPRO Magazine* http://practicepro.ca/LawPROmag/Cybercrime_and_Law_Firms_Risk_Real.pdf.

15 McNerney and Papadopoulos, see n 5 above, 1250.

16 Ellen Blanchard and Rodney Blake, 'Black Hats Look for Low Hanging Fruit: Law firms are the new target for IP theft' *IPWatchdog* (3 May 2015) www.ipwatchdog.com/2015/05/03/black-hats-look-for-low-hanging-fruit-law-firms-are-the-new-target-for-ip-theft/id=57329.

link' for hackers.[17] Whatever the metaphor, the message is clear: law firms are prime targets, and their information security is generally weaker than that of their clients or other stakeholders.

The relevance of data security in different practice settings

In some ways, the data security issue is particularly pressing for large firms, which hold the most valuable information pertaining to the largest clients, and which have large, dispersed networks (often across multiple jurisdictions) with multiple potential weak spots. On the other hand, the issue is a big challenge for small or medium-sized firms, or specialist firms servicing top-tier clients. These firms deal with sensitive and valuable information and property, but because of the economies of scale of implementing a thorough data security framework, they might be particularly stretched in terms of resources.[18]

Lawyers working in small firms may be particularly under-resourced and may never have received any training on data security risk. These lawyers are highly vulnerable. For example, a recent conveyance of a London apartment for £340,000 was the object of a targeted operation.[19] The vendor's email account was hacked, and a new set of bank account details were sent to the law firm. The lawyers did not suspect that the email was a fake, and transferred the £340,000 into the other bank account. The implications, even for small firms, can be very serious.

In-house lawyers also need to be aware of data security issues affecting their legal team and their employer's business. A survey of CEOs, board chairs and directors of publicly traded companies in the New York Stock Exchange Governance Services database, released in May 2015, showed the importance of cybersecurity to in-house counsel. In response to the question: 'For which

17 *Ibid*; J Ames, 'Cyber security: Lawyers are the weakest link' *The Lawyer* (28 October 2013) www.thelawyer.com/analysis/cyber-security-lawyers-are-the-weakest-link/3011315.article; Anupreet Singh Amole and Jane Jenkins, Freshfields Bruckhaus Deringer, 'Cyber-Security: The Risks and Opportunities' *Private Equity News* (30 March 2015); David Ruiz, 'Data Security's Achilles Heel: Some experts are saying it's not hacker or insiders, it's law firms' (2015) 22(4) Corporate Counsel; Jessica Silver-Greenberg and Matthew Goldstein, 'After JPMorgan Chase Breach, Push to Close Wall St. Security Gaps' *The New York Times* (21 October 2014) http://dealbook.nytimes.com/2014/10/21/after-jpmorgan-cyberattack-a-push-to-fortify-wall-street-banks/.

18 Nell Gluckman, 'To Satisfy Clients, Law Firms Submit to Cybersecurity Scrutiny' *The American Lawyer* (12 March 2015).

19 Nicole Blackmore, 'Fraudsters hacked emails to my solicitor and stole £340,000 from my property sale' *The Telegraph* (16 May 2015) www.telegraph.co.uk/finance/personalfinance/borrowing/mortgages/11605010/Fraudsters-hacked-emails-to-my-solicitor-and-stole-340000-from-my-property-sale.html.

of the following do you believe your general counsel/legal department would most benefit from additional expertise to add more value to your company and board in 2015?', 67 per cent of respondents named 'cybersecurity risk' as one of their choices.[20] This was the most commonly chosen risk area. The second most commonly chosen risk area, at 39 per cent, was another new frontier of risk for the legal profession: social media risk.[21]

In response to the question: 'How would you rate your general counsel with regard to his/her working knowledge of the following corporate issues/areas?', cybersecurity risk was the only area where less than half of respondents gave their general counsel a rating better than 'fair', with only five per cent giving a rating of 'excellent'. It is not only lawyers in firms that need to improve their data security competence.

The unique data security challenges facing the legal profession

The legal profession needs a sector-orientated approach to understanding and addressing data security risk. The professional ethical obligations for lawyers to maintain client confidentiality, carry out their work competently and protect property that comes into their trust set minimum data security standards for the legal profession. These obligations apply, in various forms, to lawyers in all jurisdictions. Further, professional ethics may have a bearing on how the legal profession approaches collaboration and information sharing, and create conflicts with breach notification requirements.

Confidentiality

Lawyers have a professional obligation to maintain confidentiality regarding the affairs of present or former clients, unless otherwise allowed or required by law or applicable rules of professional conduct.[22] The loss or theft of digitally stored information is a threat to confidentiality. To discharge the ethical obligation of confidentiality, lawyers must implement adequate administrative, technical and physical safeguards to protect client information.[23] They are also expected to have a reasonable awareness and

20 BarkerGilmore, *GCs: Adding Value to the C-Suite* (2015) www.barkergilmore.com/gcs-adding-value-in-c-suite.

21 See International Bar Association, *IBA International Principles on Social Media Conduct for the Legal Profession* (2014) www.ibanet.org/committees/divisions/legal_practice/impact_of_osn_on_legalpractice/Impact_of_osn_home.aspx.

22 See, for example, International Bar Association, *IBA International Principles on Conduct for the Legal Profession* (2011) www.ibanet.org/barassociations/BIC_resources.aspx, Principle 4.

23 Rhodes and Polley (eds), see n 1 above, 64.

engagement with technology.[24] What is reasonable will vary over time and across practice settings and jurisdictions, but clearly this requires more than passive reliance on the technology that lawyers use in their everyday practice. The professional obligation of confidentiality requires lawyers to be active in promoting and protecting data security.

Competence

The duty of competence is also relevant to the adequate protection of a client's electronically stored information.[25] The ABA has stated that the duty of competence includes keeping abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology.[26] In a modern practice, carrying out work in a 'competent and timely manner'[27] usually involves the use of technology (such as email, portable devices and cloud computing) that results in the electronic storage of sensitive information and creates data security risk.[28] Competent lawyers should be able to evaluate this risk and implement appropriate practices and technology to protect those files from loss or destruction, or retain an expert consultant who has the competence to do so.[29]

In some circumstances, the professional obligations of confidentiality and competence may impose a duty on lawyers to initiate a conversation with a

24 The State Bar of California Standing Committee on Professional Responsibility and Conduct, *Formal Opinion No. 2010-179: Confidentiality and Technology* (2010) http://ethics.calbar.ca.gov/LinkClick.aspx?fileticket=wmqECiHp7h4%3d&tabid=836; Canadian Bar Association, 'Guidelines for Practicing Ethically with New Information Technology', a supplement to its *Code of Professional Conduct* (2014) www.cba.org/cba/activities/pdf/guidelines-eng.pdf.

25 See, for example, the State Bar of California, n 24 above; Canadian Bar Association, n 24 above; E-Law Committee of the Law Society of South Africa, *LSSA Guidelines on the Use of Internet-Based Technologies in Legal Practice* (2014) www.lssa.org.za/index.php?q=con,363,LSSA_publishes_guidelines_on_the_use_of_Internetbased_technologies_in_legal_practice.

26 Comment [8] to American Bar Association, *Model Rules of Professional Conduct*, Model Rule 1.1, cited in James Podgers, 'The fundamentals: lawyers struggle to reconcile new technology with traditional ethics rules' (November 2014) *ABA Journal* published online at *LegalTrac* (19 May 2015) http://go.galegroup.com/ps/i.do?id=GALE%7CA389509922&v=2.1&u=usyd&it=r&p=LT&sw=w&asid=50c969003c88ab3889ab55f97eabc90b.

27 International Bar Association, *IBA International Principles on Conduct for the Legal Profession* (2011) www.ibanet.org/barassociations/BIC_resources.aspx, Principle 9.

28 Canadian Bar Association, n 24 above.

29 State Bar of Arizona, *Ethics Opinion No. 05-04* (July 2005) cited in Rhodes and Polley (eds), n 1 above, 65.

client about data security.[30] For example, at the beginning of the lawyer-client relationship, it may be prudent to discuss the data security expectations of both parties and the regulatory obligations for clients and law firms.[31] As with other areas of professional practice, lawyers must have the understanding to have frank and informative discussions with their clients about the client's interests and how their work will be handled.

Protection of client and third party property

Lawyers also have ethical obligations relating to the prudent treatment of trust funds and the preservation of client property that comes into a lawyer's trust.[32] Lawyers must implement appropriate practices and technology to safeguard client and third party property. Law firm trust funds have been the target of cyberattacks in the past, such as the theft of a 'large six-figure' amount from the trust fund of a Toronto law firm. This was a sophisticated attack involving targeted emails to the firm's bookkeeper purporting to be from a large Canadian bank, malware that mimicked the login page of the bank and direct calls to the bookkeeper purporting to be from the bank.[33]

Law firms may receive sensitive information without the informed consent of the owner of the information, or the person to whom it pertains.[34] This might occur through discovery in the course of litigation, or in the firm's capacity as legal counsel during an investigatory process. There are ethical concerns where information that is stored in a highly secure environment is compulsorily transferred, possibly without the knowledge of a third party to which it pertains, to a law firm that may have a lower level of data security.[35]

30 Rhodes and Polley (eds), n 1 above, 82. See, for example, Solicitors Regulation Authority, *Code of Conduct* (2011) www.sra.org.uk/solicitors/handbook/code/content.page, Outcome 1.12, which requires clients to be in a position to make informed decisions about the services they need, how their matter will be handled and the options available to them, and Outcome 4.2, which requires the fee earner to disclose to the client all information that is material to the client's retainer of which the fee earner is aware.

31 Rhodes and Polley (eds), n 1 above, 99.

32 International Bar Association, *IBA International Principles on Conduct for the Legal Profession* (2011) www.ibanet.org/barassociations/BIC_resources.aspx, Principle 8; Canadian Bar Association, n 24 above, 7; New Zealand Law Society, *Practice Briefing: Cloud Computing Guidelines for Lawyers* (2014) www.lawsociety.org.nz/epractice-resources/practice-briefings/Cloud-Computing-2014-07-21-v2.pdf.

33 Yamri Taddese, 'Law firm's trust account hacked, "large six figure" taken' *Law Times* (7 January 2013) www.lawtimesnews.com/201301072127/headline-news/law-firms-trust-account-hacked-large-six-figure-taken.

34 Rhodes and Polley (eds), n 1 above, 8.

35 *Ibid.*

Collaboration and information sharing

Legal professional obligations bear on the collective response of the legal sector to the data security threat. Governments and private sector commentators have called for greater collaboration and information sharing among businesses to promote best practices in data security, protect against similar threats and improve the general standard of information protection. Indeed, some law firms are working towards the formation of informal alliances that would allow them to share information about data security threats and vulnerability. In the US, major law firms including Sullivan & Cromwell, Debevoise & Plimpton, Paul Weiss Rifkind Wharton & Garrison, Allen & Overy and Linklaters have moved towards the formation of such an alliance.[36]

Lawyers face inherent difficulties in collaboration and information sharing. Boris Segalis, the US co-chairman of Norton Rose Fulbright's data protection and privacy practice, stated that 'I'm not sure the potential benefit is worth the potential risk to confidentiality and privilege'.[37] In addition to these concerns about confidentiality, law firms may justifiably be reticent to share information that might damage the firm's reputation and jeopardise existing and future client relationships.[38] In some cases, by admitting a breach a law firm may face questions about the adequacy with which it undertook its obligation to make reasonable efforts to prevent unauthorised access to client information.[39] An informed, sector-orientated approach is needed to resolve the tensions between collaborating to provide a collective defence to the growing threat of data security breaches, and concerns about confidentiality, reputation and raising issues of a lawyer's professional competence.

Breach notification

An increasing number of jurisdictions have enacted laws requiring entities that hold personal information to notify enforcement authorities and the persons to whom the information pertains in the event of a data security

36 Gluckman, n 18 above.

37 *Ibid.*

38 Emily Mermell, 'Tension between Client Confidentiality, Public Disclosure Stifling Law Firm Cyber-breach Reporting' *ACEDS* (16 April 2015) www.aceds.org/why-arent-law-firms-disclosing-data-breaches/.

39 *Ibid.*

breach.[40] Law firms often hold personal information pertaining to their clients (such as personal injury claimants) or third parties. In 2014, the UK Information Commissioner's Office (ICO) investigated 173 UK law firms for reported breaches of the Data Protection Act.[41]

Law-makers need to understand the unique position of legal professionals and how breach notification laws will interact with the framework of legal professional ethics. For lawyers, particularly those involved in cross-border work, there may be different and conflicting obligations in different jurisdictions concerning confidentiality and reporting obligations. These concerns must be balanced with the interests of business, government and all of society in reducing cybercrime. A further consideration is the need to protect privacy, particularly where information is being provided to government departments.

As with collaboration and information sharing, breach notification raises concerns about confidentiality and reputational damage. The New York City Bar has issued an ethics opinion that individuals attempting to conduct a trust fund scam are not prospective or actual clients and so lawyers do not violate their ethical obligations by reporting the scam to enforcement authorities.[42] The situation will be more complex where a duty of confidentiality does exist. For example, if a law firm holds client files that contain the personal information of the client's customers, notifying those customers of a breach that affects their personal information, and thereby disclosing that the firm was in possession of those files, would have implications for client

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40 For example, EU Data Protection Directive 95/46/EC as implemented in Member States; Data Protection Act 1998 (UK); Personal Information Protection and Electronic Documents Act ('PIPEDA') (Canada); Privacy Act (New Zealand). See further DLA Piper, *Data Protection Laws of the World* http://dlapiperdataprotection.com/#handbook/world-map-section.

41 John Leyden, 'Miscreants rummage in lawyer's silky drawers at will, despite warnings' *The Register* (16 April 2015) www.theregister.co.uk/2015/04/16/law_office_breaches_rife_foia/.

42 The Association of the Bar of the City of New York Committee on Professional Ethics, 'Formal Opinion 2015-3: Lawyers who fall victim to internet scams' (April 2015) www.nycbar.org/ethics/ethics-opinions-local/2015opinions/2161-formal-opinion-2015-3-lawyers-who-fall-victim-to-internet-scams; Ellen Rosen, 'Cybercrime at Firms Triggers Ethical Duties: Business of Law' *Bloomberg BNA* (1 May 2015) www.bloomberg.com/cybercrime-at-firms-triggers-ethical-duties-business-of-law.

confidentiality.[43] It is important for the law to consider the unique position of lawyers and clearly set out what a lawyer's obligations are.

Data security: practical considerations

Data security needs to be addressed in law firms of all sizes, through in-house counsel of small and mid-sized companies, and across all jurisdictions. The areas of risk discussed in this section exist in all practice settings, and the suggestions for addressing the data security issue are relevant for all members of the global legal profession.

Cloud computing

Cloud computing involves storing data and software on a remote server. Users can then access programs and data remotely. Typically, the remote server is operated by a third-party service provider. Cloud computing has been widely adopted because it is more flexible, cheaper and easier to maintain than traditional systems, and information is often more effectively backed up. It does, however, create vulnerabilities for information security, which lawyers need to understand. Cloud computing typically involves shifting control of data to a third party. The law firm necessarily remains responsible for protecting the security of that information.[44] The professional obligations of confidentiality and competence, discussed above, require lawyers to take reasonable care to minimise any risks to confidentiality and security of client information stored in the cloud.[45] Therefore, at a minimum it is important that law firms conduct adequate due diligence on potential third-party service providers, and include contractual terms requiring the service provider to establish and maintain adequate security measures. Lawyers also need to be aware of which jurisdiction the remote server is located in, and thus what laws and regulations need to be considered in managing data security risk.[46]

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43 Koblentz, n 38 above; E-Law Committee of the Law Society of South Africa, n 25 above; New Hampshire Bar Association, *Ethics Committee Advisory Opinion #2012-13/4 'The Use of Cloud Computing in the Practice of Law'* (2012) www.nhbar.org/legal-links/Ethics-Opinion-2012-13_04.asp; New Zealand Law Society, n 32 above; Law Society of British Columbia, *Report of the Cloud Computing Working Group* (2012) www.lawsociety.bc.ca/docs/publications/reports/CloudComputing_2012.pdf.

44 Solicitors Regulation Authority, *Silver Linings: Cloud computing, law firms and risk* (November 2013), 10.

45 E-Law Committee of the Law Society of South Africa, n 25 above; New Hampshire Bar Association, n 43 above.

46 E-Law Committee of the Law Society of South Africa, n 25 above; Law Society of British Columbia, n 43 above; New Zealand Law Society, n 32 above, 9.

Portable devices

Portable devices such as smartphones, blackberries, tablets and laptops are increasingly used by lawyers for work. Indeed, cloud computing has contributed to the use of portable devices.[47] Remote access facilitates flexible working and can improve client service. However, portable devices and their use on wireless connections often represent weak points for information security.[48] For example, using portable devices on unsecured Wi-Fi represents a clear risk for 'electronic eavesdropping'.[49] All work-related communications need to be made through a secured channel.[50] The risk of portable devices being lost or stolen necessitates encryption of the data on those devices and other security precautions, such as adequate password protection, the ability to wipe a device remotely and the immediate reporting of theft or loss of the device.[51] Confidential information needs to be irreversibly wiped from portable devices before they are disposed of (this extends even to copiers and printers, which may retain images of documents on their hard drives).[52]

Hacking

The range of sensitive information held by law firms and the diversity of potential data security threats create risks for all lawyers. Hackers range from 'script kiddies' (computer whizzes who conduct a cyberattack simply because they can) to sophisticated state actors (as was allegedly the case in the North Korean state attack on Sony). Some hackers are politically motivated, such as terrorist groups or 'hacktivists'. Others are motivated by economic gain, including organised crime groups, competitor businesses and current or former employees.

The diversity of actors and motives means that firms of all sizes can be targeted. For example, a small UK law firm, ACS:Law, had its security breached in 2010 by prominent hacktivist group Anonymous. The hackers were concerned by the firm's 'speculative invoicing' tactics of targeting

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47 Solicitors Regulation Authority, *Silver Linings: Cloud computing, law firms and risk* (November 2013), 11.

48 Rhodes and Polley (eds), n 1 above, 9.

49 Solicitors Regulation Authority, *Silver Linings: Cloud computing, law firms and risk* (November 2013), 11.

50 *Ibid.*

51 Martin Prinsloo, 'Keeping Your Law Firm Safe from Cyber Threats' *Broward Daily Business Review* (25 March 2015).

52 Rhodes and Polley (eds), n 1 above, 72.

individuals the firm claimed were engaged in illegal file sharing.[53] The attack resulted in the crash of the firm's website. During attempts to get the website running again, the unencrypted emails sent to those accused of illegally sharing pornography were made publicly visible. Privacy International sued the firm on behalf of the individuals whose information was breached; the lawyer who owned the firm was fined £1,000 by the UK Information Commissioner's Office. The fine would have been £200,000 if the firm had not gone out of business.

In 2012, Anti-Sec, an offshoot of Anonymous, hacked into the servers of the small US law firm Puckett & Faraj and obtained nearly 3GB of emails, numbering tens of thousands of messages and dating back two years.[54] This was in response to the firm's defence of staff sergeant Frank Wuterich, who was accused of leading a group of Marines responsible for the deaths of 24 unarmed Iraqi civilians at Haditha.[55]

In a very different scenario, in 2011 several large Canadian law firms were subject to an 'advanced persistent threat' (APT), which is thought to have originated from a state actor.[56] BHP Billiton made a $38bn bid to take over Canadian-based Potash Corporation. Canadian law firms representing the parties to the transactions, as well as other stakeholders such as the Canadian government and clients of the law firms, were the target of a coordinated attack originating from China. Some experts speculate that the attacks were related to efforts by China's state-owned chemical company, Sinochem Group, to disrupt the BHP takeover bid.[57]

Hackers often rely on malware (malicious software). One type of malware that has gained notoriety is 'ransomware', which holds a target's information and demands money for its return; sometimes, the money is paid and the data deleted anyway.[58] Other malware, called 'botnets', combine part of

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53 'ACS:Law fined over data breach' *BBC News* (11 May 2011) www.bbc.co.uk/news/technology-13358896; 'ACS:Law solicitor Andrew Crossley suspended by SRA' *BBC News* (8 March 2012) www.bbc.co.uk/news/technology-16616803.

54 R Gallagher, 'Anonymous Splinter Group Anti-Sec Wages War on "Profiteering Gluttons"' *The Guardian* (27 February 2012) www.theguardian.com/technology/2012/feb/27/anonymous-splinter-group-antisec-waging-war.

55 Dominic Rushe, 'Anonymous publishes trove of emails from Haditha marine law firm' *The Guardian* (6 February 2012) www.theguardian.com/technology/2012/feb/06/anonymous-haditha-killings.

56 Rhodes and Polley (eds), n 1 above, 126; Greg Weston, 'Foreign Hackers Target Canadian Firms' *CBC News* (29 November 2011) www.cbc.ca/news/politics/foreign-hackers-targeted-canadian-firms-1.1026810.

57 Rhodes and Polley (eds), n 1 above, 126; Weston, n 56 above. The bid was ultimately blocked by the Canadian government.

58 Solicitors Regulation Authority, *Spiders in the web: The risks of online crime to legal business* (March 2014), 8.

each infected computer's processing power to conduct targeted attacks. An example of using 'spear phishing' emails to install malware on a target system is to email a law firm purporting to be a job applicant, with an attachment that purports to be a CV. The attachment in fact contains a malware program. This should usually be preventable by adequate anti-virus systems, but it has been successful on a number of occasions.[59]

Other risks include 'malicious insiders',[60] allowing lawyers to BYOD (bring your own device), threats based on accidental, inadvertent or natural events and hacking of law firms' business partners.[61] For example, one Washington, DC law firm's external cybersecurity consultant was hacked, exposing the law firm's work for the Chamber of Commerce and resulting in the filing of an ethical complaint against three of the firm's lawyers.[62]

Commercial identity theft

Lawyers should be aware of the risk of commercial identity theft, where clients or members of the public receive emails purporting to be from their firm.[63] This can damage the reputation of the lawyer, the firm and the legal profession, and cause significant loss to clients or members of the public. These scams can be highly sophisticated, drawing on detailed information about the lawyer and law firm. One measure to protect against this risk is to ensure that electronically stored information about a lawyer or law firm is adequately protected or securely destroyed.[64]

Insurance

If a data security breach does occur, insurance is an important way to mitigate the damage. Law firms of all sizes need to examine their insurance policies to ensure that they have adequate coverage for the diverse data

59 *Ibid.*

60 The US Department of Justice has brought several cases against Chinese employees who steal intellectual property and trade secrets: Marisa Kendall, 'Feds Charge Chinese Engineers With Stealing Silicon Valley Technology' *The Recorder* (19 May 2015) www.therecorder.com/id=1202726949251/Feds-Charge-Chinese-Engineers-With-Stealing-Silicon-Valley-Technology#ixzz3cfmV6wZl.

61 Rhodes and Polley (eds), n 1 above, 13.

62 *Ibid* 26.

63 'Cybercrime issue is escalating, says SRA' *Solicitors Regulation Authority* (1 June 2015) www.sra.org.uk/sra/news/press/cybercrime-increasing-june-2015.page; Solicitors Regulation Authority, *Spiders in the web: The risks of online crime to legal business* (March 2014), 14.

64 *Ibid.*

security risk environment.[65] The cost of incomplete coverage could be devastating: in 2014, the average cost of a corporate data breach in the United States was $5.9m, a figure that will continue to increase.[66] Lawyers should not assume that any data security breach will be covered by their commercial general liability insurance, professional liability insurance or other policies.[67] If purchasing a specific cyber insurance policy, lawyers should understand that these are relatively new insurance products, with significant variation between policies.[68] Not all policies will fit the unique risk profile of a firm. Data security insurance is an area that warrants a proactive approach, careful attention to detail and, in many cases, consultation with an insurance professional.[69]

What do lawyers need to know?

Lawyers must avoid the trap of assuming that their IT department will protect them from data security risk, or that their firm is too small to be targeted by hackers.[70] As a start, lawyers should know:

- what information their firm stores;
- where it is stored;
- how information is separated out within the firm;
- what technical, physical and administrative protections are in place;
- what is required to maintain the integrity of those protections.

Most security breaches occur as a result of human error of some kind.[71] Lawyers should have a sense of vigilance and an understanding of data security risk. For example, lawyers should understand the risks of opening email attachments and using USB sticks, and ways to spot issues such as unauthorised access or a misbehaving infected computer.[72]

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65 See Monica Bay, 'Think You Don't Need Cyber Insurance? Think Again!' *Bloomberg BNA* (22 May 2015) https://bol.bna.com/think-you-dont-need-cyber-insurance-think-again/; Michael N DiCanio, 'Preparing for the Inevitable: Insurance for Data Breaches' *New York Law Journal* (19 May 2015).

66 DiCanio, n 65 above.

67 *Ibid.*

68 *Ibid.*

69 Scott J Shackelford, 'Should Your Firm Invest in Cyber Risk Insurance?' (2012) 55(4) Business Horizons 349.

70 Rhodes and Polley (eds), n 1 above, 192.

71 Steve Ragan, 'Law firm says human error to blame for client breaches in 2014' *CSO* (18 May 2015) www.csoonline.com/article/2923023/disaster-recovery/law-firm-says-human-error-to-blame-for-client-breaches-in-2014.html; Blanchard and Blake, n 16 above.

72 Canadian Bar Association, n 24 above.

For lawyers in management positions in medium and large firms, implementing an adequate internal data security framework involves activities such as:[73]

1. Creating an inventory of the digital assets in the firm.
2. Providing training and education to legal and administrative staff.
3. Conducting periodic cybersecurity risk assessments.
4. Developing security strategies and controls. This should include separating out information so that lawyers and staff can only access the information that they need to, thereby reducing the threat of current or former employees intentionally or otherwise breaching the firm's cybersecurity defences. Limiting the access and control granted to partners, who are owners of the firm, will require clear articulation of the risks and how they are best managed.[74]
5. Developing an incident response plan, including understanding any reporting obligations.
6. Examining insurance policies.[75]
7. Implementing oversight of external business and third-party service provider arrangements.
8. Conducting ongoing monitoring and analysis, which is required to maintain the level of security and detect breaches if they occur. It is a scary thought that breaches may continue undetected for months, and indeed breaches may never be detected.[76] The *2013 Trustwave Global Security Report* revealed that in 2012, nearly two-thirds of businesses that became aware that they had been the subject of a cyberattack took over 90 days to discover the breach, with nearly a fifth of firms taking over one year to discover the attack. The value that lawyers intuitively place on confidentiality and privacy will need to make room for monitoring and analysis of computer systems and communications.[77]

The protection principles – prevent, detect, react and deter – are always effective for incident management and timely communication of security events associated with information systems.

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73 See for example the Rhodes and Polley (eds), n 1 above, 50; Prinsloo, n 51 above.

74 Rhodes and Polley (eds), n 1 above, 109.

75 DiCanio, n 65 above.

76 Solicitors Regulation Authority, *Spiders in the web: The risks of online crime to legal business* (March 2014), 5, citing the *2013 Trustwave Global Security Report.*

77 Rhodes and Polley (eds), n 1 above, 108.

Industry standards and auditing by clients

Law firms are using industry standards as a way to certify their data security protections: the International Organisation of Standardisation (ISO) accreditation 27001 is being taken up by larger law firms, particularly in the US.[78] Indeed, some large clients, such as Goldman Sachs or JP Morgan Chase, require more than an ISO 27001 accreditation, conducting their own audits on firms.[79] A 2014 KPMG survey of FTSE 350 companies found that 33 per cent of respondents audited third parties, such as law firms, on cyber risk.[80]

As clients increasingly scrutinise how their data will be protected, data security is becoming a competitive differentiator. It is large firms that are best positioned to take advantage of this; the cost of acquiring the ISO accreditation, or meeting the exacting requirements of large clients, means that it is often not feasible for small and mid-sized or specialist firms.[81]

Outlook for the global legal profession

Data security has become a risk issue that is truly global in nature. Cyberspace transcends national borders. Threats can originate from anywhere, and all firms are potential targets. Malware is available for purchase online; the commoditisation of cyber tools makes the theft of electronically stored information more widely accessible.[82] However, at present the leaders in law firm data security are top-tier law firms in the US and UK. More needs to be done in less developed legal sectors, where there may be fewer resources and less expertise, but where the risk is no less compelling.

Data security is increasingly resource intensive, requiring technology, expertise, staff training and, for medium to large firms, a well-staffed IT department. One computer security firm quotes the cost for a large law firm to hire them as a cybersecurity consultant (to work with the firm over a period of months to bring its cybersecurity framework up to acceptable

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78 Gluckman, n 18 above.

79 *Ibid.*

80 KPMG, *FTSE 350 Cyber Governance Health Check: An insight into the issues of today and tomorrow* (2015), 1.

81 Gluckman, n 18 above.

82 McNerney and Papadopoulos, n 5 above, 1248; Juniper Research, *The Future of Cybercrime & Security: Financial and Corporate Threats & Mitigation*, cited in 'Cybercrime Will Cost Businesses Over $2 Trillion by 2019' (Juniper Research, 12 May 2015) www.juniperresearch.com/press/press-releases/cybercrime-cost-businesses-over-2trillion?utm_source=gorkanapr&utm_medium=email&utm_campaign=cybercrime15pr1.

industry standards) at around $130,000.[83] One estimate for the cost of a large firm going through the procedure to obtain a three-year ISO 27001 certification is $30,000.[84]

The global legal profession needs sector-orientated assistance. This is an issue that calls for the legal profession to act collectively to raise awareness and provide education, training and other resources. It is essential for the legal profession to encourage lawyers and law firms to conduct a cyber readiness test and ensure that a specific cyber-incident response plan is in place. There is a role for an international organisation like the International Bar Association (IBA), with its global membership of bar associations, law societies and legal professionals, to assist lawyers to achieve adequate standards of data security and to ensure that the unique position of lawyers is accommodated in legislative responses to data security risk.

Conclusion

Data security should be a risk priority for all members of the global legal profession. There is a pressing need for greater proactivity and engagement by all lawyers. Lawyers cannot rely on their IT department or assume that technology will look after itself. As an initial step, management must take a leadership role in promoting attention and vigilance at every level of a law firm's business. However, addressing the data security issue will be resource intensive, and many lawyers and law firms will benefit from assistance. Moreover, lawyers' professional ethical obligations of confidence, competence and protecting property in their trust requires a risk management approach tailored to the legal profession. It will be important for bar associations and international organisations such as the IBA to raise awareness and provide education, training and other resources to assist lawyers in all jurisdictions and practice settings to protect their valuable digital assets.

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83 Gluckman, n 18 above.

84 *Ibid.*

CASE COMMENT

Recent Developments in the Territorial Scope of UK Employment Law

Sarah Ozanne*

The territorial scope of UK employment law is a complicated and developing legal area. In the absence of express statutory provisions it has been left to case law to set out and develop the necessary parameters. This article reviews the background to this legal area, including the pivotal case of *Lawson v Serco* from which general legal principles in this area emerged, and looks at recent cases where the outcome was not what might initially have been expected.

Lawson v Serco and the establishment of general legal principles

Historically, the Employment Rights Act 1996 (ERA), which contains many key statutory employment rights including the right not to be unfairly dismissed, expressly limited its application to employees who ordinarily work inside Great Britain. This position was however amended by the removal of the relevant provision in 1999 and the ERA now contains no clarification on what connection, if any, that the employee or his employment must have with Great Britain in order to benefit from its provisions. Interpreting the ERA literally would mean that it applies to any individual who works under a contract of employment anywhere in the world, but this would give it a

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breadth of scope that it wouldn't appear was ever intended. This left the issue to be determined by case law.

The leading case in this area is that of *Lawson v Serco*.[1] Serco was a UK company, operating on a worldwide basis, that engaged Mr Lawson to work as a security supervisor on Ascension Island, where the company had a contract to work at the RAF base. Ascension Island is a 35-mile island in the South Atlantic and is a dependency of the British Overseas Territory of St Helena. After six months in post Mr Lawson resigned claiming constructive unfair dismissal. Lord Hoffmann provided the key opinion in the case during which he noted that the ERA contains no geographical limitation on its application and concluded that it was inconceivable that Parliament intended to confer rights on employees with no connection with Great Britain.

In his judgment Lord Hoffmann identified the 'standard case' where an individual might receive unfair dismissal protection. This relates to employees ordinarily working in Great Britain. Whereas the pre-1999 law focused on the contract of employment, Lord Hoffmann concluded that the key question was whether the employee was working in Great Britain at the time of his dismissal, rather than what was contemplated by the employer and employee at the time when the contract was made, which could have been some years earlier. However, he acknowledged that the contents of the contract and the history of the contractual relationship may be relevant to determine whether the employee is working in Great Britain, or just on a casual visit.

Lord Hoffmann also identified a couple of exceptions to the standard case where the employee had the benefit of UK employment law. These were peripatetic employees and expatriate employees. With regard to the former, he determined that their base should be treated as their place of employment, even if they spend weeks or months working overseas. In this regard the contract should be considered but may not be of much assistance, and one should look at the conduct of the parties and the way they have been operating the contract in practice.

By contrast, in the case of expatriate employees Lord Hoffmann acknowledged that the 'concept of a base, which is useful to locate the workplace of a peripatetic employee, provides no help in the case of an expatriate employee'. He stated that cases where expatriate employees come within the scope of UK employment law would be unusual, but acknowledged that some would. This would need to be more than the fact that an employee working abroad is employed by a UK employer or that the employee him/herself is British. Lord Hoffmann suggested that this may include an employee posted abroad by a British employer for the purposes

1 [2006] ICR 250.

of a business carried on in Great Britain. In particular, he gave the examples of a foreign correspondent employed by a UK newspaper but posted overseas or an expatriate employee of a UK employer operating within an extraterritorial enclave of a foreign country. It was this latter situation into which Mr Lawson fell.

These examples were elevated to statements of general principle in two subsequent Supreme Court cases: *Duncombe v Secretary of State for Children, Schools and Families*[2] and *Ravat v Halliburton Manufacturing and Services Ltd*.[3]

In the *Ravat* case Lady Hale stated:

> 'The principle appears to be that the employment must have stronger connections both with Great Britain and with the British Employment law than any other system of law. There is no hard and fast rule and it is a mistake to try and torture the circumstances of one employment to make it fit one of the examples given for they are merely examples of the application of the general principle.'

Application of the general principles in recent cases

Lord Hoffmann didn't exclude the possibility of other circumstances in which an employee and the employment relationship could have equally strong connections with Great Britain and British employment law, and so would fall within the territorial scope of section 94(1) of the ERA. One such scenario was identified by the Employment Appeal Tribunal (EAT) in the case of *Lodge v Dignity & Choice in Dying and Another*.[4] The EAT in *Lodge* determined that, unlike the average expatriate, an employee does not need to be posted abroad to benefit from bringing claims under the ERA and that this can include employees working remotely of their own choice.

Mrs Lodge is an Australian citizen who was employed by a British not for-profit charity under the terms of a contract of employment governed by the laws of England and Wales. She worked from the company's office on Oxford Street but occasionally worked remotely from her home in west London using an IT application installed on her laptop computer. A few months after her appointment in February 2008 she moved to Australia to be closer to her ill mother. She remained employed by the charity but worked remotely from Australia, using the application installed on her laptop, until June 2013 when she resigned and brought claims of constructive unfair dismissal and whistleblowing.

2 [2011] ICR 495.
3 [2012] ICR 389.
4 UKEAT/0252/14.

The employment tribunal refused jurisdiction to hear Mrs Lodge's claim on the basis that she did not satisfy the expatriate employee test set down by Lord Hoffmann in the *Lawson* case and so did not fall within the territorial scope of UK employment law. This was because she had moved to Australia at her instigation rather than being posted there. The employment tribunal judge also stated that Mrs Lodge had failed to show 'an especially strong connection with Great Britain and British employment law'.

The EAT disagreed. It held that although Mrs Lodge hadn't been posted abroad the fact that her employer allowed her to work remotely from Australia did not prevent her falling into a sub-category of Lord Hoffmann's expatriate employee. Mrs Lodge remained connected with Great Britain through her employment on a contract subject to the laws of England and Wales and the fact that her employer's activities are located in Great Britain. The EAT judge also found as relevant the facts that she could not pursue her claims in Australia and a grievance she had brought had been handled in London. However, the key fact was that all the work done by Mrs Lodge was for the benefit of her employer's London operations. If this had not been the case then it is more likely that the decision would have been that she did not fall within the territorial scope of UK employment law.

This case can be contrasted with the more recent case of *Olsen v Gearbulk Services Ltd and Another*[5] in which the EAT determined that an employee based in Switzerland but spending more of his working time in the UK than any other country did not have a sufficiently strong link to benefit from UK employment law. By comparison to Mrs Lodge, Mr Olsen was a Danish national domiciled in Switzerland and based there for the purposes of his international role as strategy and business development director. Mr Olsen had rejected a contract of employment subject to English law and instead plumped for one governed by Bermudian law and his salary and expenses were processed in Bermuda. This was part of his personal tax strategy, through which he ensured that he never spent enough time in the UK to be subject to UK taxation. Another practical step taken by Mr Olsen to distance himself from the UK was to ensure that his accommodation in the UK was contracted via a family company rather than in his own name.

In this case the parties agreed that Mr Olsen was a peripatetic employee based outside the UK fulfilling a role that, although it involved the UK, was international in its scope. Consequently Mr Olsen did not have a sufficiently close connection with the UK for the purposes of bringing an unfair dismissal claim. The EAT concluded that the fact that as Mr Olsen freely made a choice of law and jurisdiction that choice should be respected. In this scenario it

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5 EAT/0345/14.

seems naturally fair that having orchestrated the arrangements relating to his work life so as not to become subject to the UK tax regime Mr Olsen's entitlement to rely on UK employment law should be judged in light of those arrangements.

Conclusion

The law relating to the territorial scope of UK employment law has gone through a dramatic evolution in the last nine years. From the quagmire pre *Lawson v Serco* it has emerged with a set of general principles that are being fleshed out by ongoing case law. However, given the increasing globalisation of the workforce and the impact of new technologies and working styles, these principles are being applied to increasingly diverse factual circumstances. In light of that, what it is important for employers to remember is that the facts of each case will need to be considered to determine whether UK employment law might be relevant. Therefore just because an employee spends a significant proportion of their time working in the UK it shouldn't be assumed that they will reap the protection of UK employment law and, conversely, simply because they don't work in the UK that they will not.

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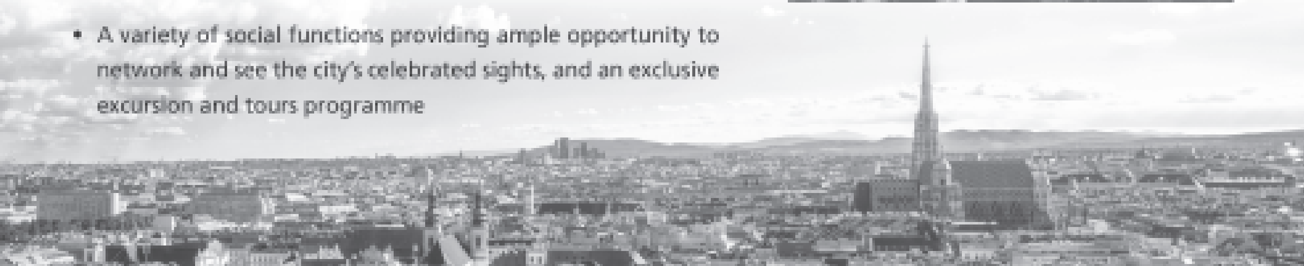

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BOOK REVIEW

Letters of Credit: The Law and Practice of Compliance
Ebenezer Adodo
Oxford University Press (2014); 400 pages (hardback); £155; ISBN-10: 0199674078; ISBN-13: 978-0199674077.

This book addresses a number of the underlying legal and practical issues faced when interfacing with letters of credit in the commercial environment. By traversing the legal issues presented by both the Anglo and US legal systems, the book offers practical solutions to assist in developing good market practice and compliance. In addition, and where appropriate, Adodo highlights where law and practice in other jurisdictions diverge from those primarily covered in the book.

The book first considers the business framework and objectives behind letter of credit transactions and by assessing key features explores the consequences of failing to issue letters of credit in compliance with underlying contractual obligations. After considering the consequences for each party of a non-compliant letter of credit, the book continues to explore the rights and liabilities of the parties when a conforming, operative letter of credit has been issued. Throughout the book, Adodo provides useful clarification as to the business purposes underlying the various stages of letter of credit transactions, which the courts are eager to give effect to when presented with disputes in this area.

In aiming to produce a resource that is accessible to a wide range of market participants, Adodo's commentary includes an initial discussion of the widely incorporated ICC Uniform Customs and Practice for Documentary Credits (UCP 600) and its predecessors, together with the potential pitfalls associated with express incorporation of it or other uniform rules into contracts. Adodo is then careful to guide his readers through matters where the UCP 600 fails accurately to accord with relevant laws and industry practice.

The book includes a clear index that allows the reader to move logically through the considerations to be made at each stage of a letter of credit transaction. Further, its division into a distinct number of parts makes it easy to navigate and turn to a particular area. As well as including a helpful reference of cited cases, the book includes separate tables of the national legislation, conventions, ICC codes of rules and banking practices and provisions from the American Uniform Commercial Code referenced in the book. Through inclusion of detailed industry practice and guidance in conjunction with rigorous legal commentary, Adodo's book is as useful a guide for uninitiated practitioners, mercantile and banking parties as it is for seasoned practitioners operating in an international sphere. This is of particular importance in this international practice where business custom often informs the development of the legal framework.

Thea Wilkinson
Associate, Gibson Dunn

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