WORLD COMMERCE REVIEW

ISSN 1751-0023
VOLUME 4 ISSUE 1 ■ MARCH 2010

Navigating the Risks of Trade Compliance

Karen Lobdell asks "Can you afford not to?"

Improving Russia's "Investment Climate"
China's Future Role on the World Stage
Regulating Bank Systemic Risk

Review of the Fifth Global Congress on Combating Counterfeiting and Piracy

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These are the 'ALL HITS' Super 7 key reasons that make Durban attractive to both residents and visitors alike.

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Recovery Was Never Going To Be Easy

Most of the developed world has staggered out of recession, thanks to the various fiscal measures employed to boost the economy. These boosts are now coming to an end. Consumer confidence is weakening.

Globally there are signs that the period of ultra-low interest rates and other methods of monetary expansion are drawing to an end. In the developing world China and India are tightening policy.

If this downturn goes to book then there will be some months to go before global growth speeds up. The smooth exit from the monetary and fiscal stimulus seems unlikely.

A wave of industrial and social unrest is building across Europe as workers resist attempts by governments and private companies to impose austerity policies, drive down wages and rescue some nations from near-bankruptcy. Europe's economy is not clear of recession and with unemployment rising and demands for austerity growing, Europe's workers are becoming increasingly restive.

Consumer confidence in the US has weakened, with homeowners in particular being worried about their future earnings and employment prospects. Any deterioration in consumption is serious for everybody else.

Macroeconomic imbalances, the increased complexity of financial innovations and weaker transparency, disincentives and agency problems, including a permissive supervisory environment, together created an explosive situation that eventually set off the financial crisis.

The four factors that resulted in the financial crisis have been partially addressed. Unfortunately, international agreement is not forthcoming, particularly now that governments have to temper their fiscal and monetary stimuli. Global economic imbalances remain, the financial system is still opaque, moral hazard can only be dealt with when governments refuse to guarantee 'casino banking', and more regulation is not the answer to ignorance.

The challenge for governments is to create confidence in their policies (by both their populace and outside investors) whilst at the same time creating an environment where the financial crisis cannot reappear. Unfortunately the politicians appear to be losing this battle. As Keynes famously observed, monetary policy can be as ineffective as pushing on a string when an economy has been drained of all its confidence. ■

Phoenix Multimedia
5 The Old Grammar
Old Grammar Lane
Bungay
Suffolk
NR35 1PU
United Kingdom

www.worldcommercereview.com

Tel: +44 (0)1986 892028

Email: info@worldcommercereview.com

PUBLISHERS
Tom Forster
Roy Williams

MANAGING EDITOR
Tom Forster

EDITORIAL TEAM
Tom Page
Kate Warwick

SALES DIRECTOR
Paul Murphy

SALES TEAM
Phil Thompson
John Walsh

CIRCULATION MANAGER
Andrew Kilby

PRODUCTION MANAGER
Michael Day

DESIGN AND PRODUCTION
West Riding Media Solutions

ISSN 1751-0023

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Please see the article: "Navigating the Risks of Trade Compliance – Can You Afford Not To?" by Drinker Biddle's Karen A. Lobdell, Director, Trade Security & Supply Chain Services, in this issue of World Commerce Review.

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Improving Russia's "Investment Climate": Will the Latest Wave of Judicial Reform Succeed?

Bill Bowring is Professor of Law in the School of Law, Birkbeck, University of London

President Dmitry Medvedev appears perfectly to understand the crucial importance of judicial reform if Russia is to attract significant investment. On 4 February 2010, at a meeting to which I will refer further below, he said the following:

> *"… the investment climate in our country is directly dependent on the judicial system efficiency. Every time I meet with Russian entrepreneurs or foreign investors, they always say the same thing: if Russia is to have a first-class investment climate, the judicial system has to develop, mature and be able to effectively discharge its responsibilities."*

Since the early days of his Presidency, Medvedev has been highly critical of what he terms "legal nihilism" in Russia. On 10 September 2009 in his unprecedented article published on the internet, entitled *"Go Russia!"*, Medvedev described Russian as having *"a primitive economy based on raw materials and endemic corruption."* He promised *"measures to strengthen the judiciary and fight corruption"*, but also declared that *"An effective judicial system cannot be imported."*

He then very specifically promised:

> *"Our judicial system must be a central component here. We have to create a modern efficient judiciary, acting in accordance with new legislation on the judicial system and based on contemporary legal principles. We also have to rid ourselves of the contempt for law and justice, which, as I've said repeatedly, has lamentably become a tradition in this country… We need to eliminate attempts to influence judicial decisions for whatever reasons. Ultimately, the judicial system itself has to understand the difference between what it means to act in the public interest or in the selfish interests of a corrupt bureaucrat or businessman… It is the job of the courts with broad public support to cleanse the country of corruption. This is a difficult task but it is doable. Other countries have succeeded in doing this".*

Those statements not only amount to a startling indictment of the present state of the judicial system in Russia, but highlight the crucial role of the judiciary in eliminating corruption and helping to modernise Russia.

The urgency of Medvedev's call has been confirmed many times by those seeking to invest in Russia. In October 2009, Bill Browder, whose Hermitage Capital Management was one of the largest foreign portfolio investors in Russia by 2005, told an audience at Stanford University that *"Anyone who would make a long-term investment in Russia right now, almost at any valuation, is completely out of their mind. My situation is not unusual. For every me, there are 100 others suffering in silence."* As if to confirm Browder's fears, the Hermitage lawyer Sergey Magintsky, who, on Browder's behalf, had been fighting corruption in Russia, died in custody in Moscow on 16 November 2009. As I show below, his death provoked a furious scandal in Russia and abroad.

The need for reform was highlighted in October 2009 with the publication of another report ordered by Institute of Contemporary Development (ICD) – President Medvedev is the Chairman of its Board of Trustees - and prepared by the Centre for Political Technology. This report is entitled *"The Judicial System of Russia. The Fundamentals of the Problem."* The report was based on qualitative sociological research carried out in 2009, by means of expert interviews in several regions of Russia with judges and retired judges, advocates, academic lawyers, business people and NGOs.

The report concluded that the main problem for the judicial system in Russia is not its corruption, which does not exceed the level of corruption in Russia as a whole, but the high level of dependence of judges on government officials. The research showed cases which do not concern the interests of government bodies are decided objectively. But in the most significant cases judges protect the interests of the officials and not those who are actually in the right. A case decided in accordance with the law, but not in the interests of officials, will be overturned on appeal and returned for further consideration. And the more frequently judgments are overturned, the more grounds there will be for dismissing a judge who has simply decided according to law. Judges bear these unwritten rules in mind, and make their own conclusions as to which cases to decide according to law and which not.

The research revealed all the levers by means of which the dependence of judges is maintained within the system itself. The most important factor in the work of judges, the report says, is fear and dependence on the chairman of the court. The chairman of every court has powerful levers for putting pressure on judges. The chairman decides on the distribution of cases to particular judges, awards bonuses, and resolves the judges' housing problems. The promotion of a judge is decided by the chairman, and the chairman may take disciplinary proceedings against a judge right through to the judge's dismissal. At the same time, the chairman of any court in Russia is appointed and re-appointed by the President of the Russian Federation, which ensures the chairman's dependence on the authorities. Thus, a rank and file judge when taking a decision must keep an eye on the court chairman, and the chairman in turn must correctly interpret signals from the Kremlin, the local administration, influential government officials, politicians and businessmen.

Thanks to these levers, government officials have at their disposal a "directed" court, which can be used in part as a disciplinary mechanism and as an instrument for advancing the interests of particular economic groups.

The report also contains statistical data showing that the rate of acquittal in non-jury cases is less than 1%. The judges themselves recognise that acquittals are reversed on appeal 30 times more often than convictions. This is why convictions predominate, and there is a fear of acquitting. The authors of the research conclude that the present position of judiciary may be improved by attracting competent professionals to the ranks of the judges, but it will not be possible to retain them. They also consider that the number of complaints to the European Court of Human Rights will continue to grow. They add that the contemporary Russian judicial system, as in the Soviet times, cannot lead to independent justice. This does not mean that every judicial decision is dictated by someone or other. It means that any decision in any case may be dictated.

It will be a complex task to reform the judicial system. According to Vyacheslav Lebedev, the long-serving Chairman of the Supreme Court of the Russian Federation, there are 25,000 judges of general jurisdiction in Russia, and in 2009 the President appointed altogether 2000 new judges. In 2009 363 judges of general jurisdiction were on the instructions of their court chairman. Of them 61 were dismissed. A judge dismissed in this way also loses rights to compensation and to a pension. 302 judges received warnings, and nine were subjected to criminal proceedings, five of them for intentionally handing down grossly unjust decisions.

Lebedev also revealed that in 2009 there were 602 jury trials, 12% more than in 2008, and with an acquittal rate of 18.7%. However, 19% of acquittals were overturned on appeal. This must be set against the fact that in 2008 alone the courts of general jurisdiction heard 13,400,000 civil cases, 1,100,000 criminal cases, and 5,682,000 cases

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concerning administrative violations (misdemeanours).

Since October 2009, there have been two dramatic and positive developments. First, on 21 November 2009, the Constitutional Court of the Russian Federation ruled that as a result of Russia's signature of Protocol 6 to the European Convention on Human rights (ECHR), and despite the fact that it has never ratified, Russia may not impose the death penalty. This was, effectively, abolition.

Second, on 15 January 2010 the State Duma finally voted to ratify Protocol 14 to the ECHR, on reform of the procedure of the Strasbourg Court, which Russia had signed in May 2006 and long delayed ratifying. The Federation Council voted in favour on 27 January, and President Medvedev signed the Law on Ratification on 4 February 2010. Russia was the last of the Council of Europe's 47 member states to do so.

Are these harbingers of real reform?

President Medvedev marked the occasion by inviting the heads of the highest courts in Russia – Valeriy Zorkin, Chairman of the Constitutional Court, Vyacheslav Lebedev, Chairman of the Supreme Court, and Anton Ivanov, Chairman of the Higher Arbitrazh Court – along with other senior officials from his Administration, to his residence at Gorky outside Moscow, where, as I noted above, he stressed the vital importance of judicial reform for Russia's economic future. He also expressed the hope that as a result of his proposed reforms, Russians would be less likely to turn to the Strasbourg Court. The greatest number of applications, one quarter of the total, come from Russia – 11,000 in 2008 and 14,000 in 2009.

Also on 4 February 2010 Medvedev's ICD published another report, entitled *"21st-Century Russia: Reflections on an Attractive Tomorrow"* signed by the influential commentators Igor Yurgens and Yevgeny Gontmakher. An article in the English-language *Moscow Times* reported many Russian commentators writing off the report as PR by Medvedev.

At the centre of its argument the report placed the necessity of judicial reform. This provoked a high degree of scepticism. Alla Ivanova in the *Nezavisimaya Gazeta* rejected the proposals as proposing the "Ukrainisation of the whole country" (a reference to Lenin's vision of the "electrification of the USSR"). The sober business daily *Vedomosti* commented with a headline "Back to the future…" – a section of the report is entitled "Back – to the Constitution", and in the view of the *Vedomosti* article many of the proposals appear to signal a return to Yeltsin's policies.

This is not the first attempt at judicial reform since the collapse of Communism in 1991. The fall of the USSR was preceded by publication of the *Conception of Judicial Reform* published on 24 October 1991, and the enactment on 22 November 1991 of the *Declaration of the Rights and Freedoms of the Person and Citizen* by the Supreme Soviet of the RSFSR. The Constitutional Court, created as the USSR reached its death-throes, started work in January 1992, followed on 26 June 1992 by enactment of the Law "On the Status of Judges of the Russian Federation". On 16 July 1993, enactment of the new Part X to the Criminal Procedural Code (UPK) introduced jury trial, as an experiment, in nine Russian regions.

In a second wave of reform, President Putin from 2000 to 2003 expressly referred to himself as following in the footsteps of the great reforming Tsar, Alexander II, and his law reforms of 1864. Putin too presided over creation of a system of justices of the peace; installation of jury trial throughout Russia with the exception of Chechnya; enhanced judicial status; and a much reduced role for the prosecutor in criminal and civil trials.

The reforms of 2001-2003 were driven through the Russian Parliament against strong opposition from the Prokuratura, and included the three new procedural codes enacted from 2001 to 2003, Criminal, Arbitrazh (Commercial), and Civil, as well as the radical improvements to Yeltsin's Criminal Code of 1996, 257 amendments in all, which were enacted on 8 December 2003. However, this second phase of legal and judicial reform from 2000 came to an abrupt end in late 2003, simultaneously with the arrest of Mr Khodorkovsky and the destruction of YUKOS.

What, then, of President Medvedev's proposed reforms? Will they succeed where the two previous waves have manifestly failed?

On Friday 29 January 2010 the State Duma unanimously approved at first reading a package of laws to reform the judicial system, presented by Medvedev's administration. The most important innovation is the abolition of the present appeal by way of cassation – appeal on a point of law, where success means a new trial in the first instance court. Instead there will be appeal by way of rehearing, where the appeal court will be able to render its own final decision. At present such appeal is only possible from the Justices of the Peace, the lowest level of the courts of general jurisdiction.

There are now five draft laws before the State Duma concerning judicial proceedings and the judicial system itself. According to the advocates from the leading law-firm Padva & Epshtein, as reported on the lawyers' web-site *Pravo.ru*, the most important of these draft laws are:

> 1) Introduction of appeal by way of a new hearing leading to a new judgment, in civil cases in the courts of general jurisdiction. This will take the place of cassation leading in all cases to reference back to the lower court, and the possibility of supervisory review (nadzor), which can re-open a case long after a final judgment has been delivered. Supervisory review has been condemned by the European Court of Human Rights in a series of cases, since it violates the principle of legal certainty. Supervisory review will now be restricted to the very highest instance, the Presidium of the Supreme Court.
>
> 2) Amendments to the law governing the corporate bodies of judges, especially in the Supreme Court, strengthening the self-organisation of the judges.
>
> 3) Changes to the procedure for subjecting judges to criminal investigation.
>
> 4) Changes to the laws on the system of judges of general jurisdiction, one of which is a Law of the Russian Socialist Federation of Soviet Republics of 1986. The objective of the changes is to strengthen and simplify the existing system, which will continue to have the Supreme Court of the Russian Federation at its head.
>
> 5) Amendments to the laws governing the Arbitrazh (Commercial) Court system in Russia, making possible a combined plenum of the Supreme Court and the Higher Arbitrazh Court. Thus, where a necessary a common position can be taken with regard to both the Arbitrazh Courts, and the Courts of General Jurisdiction.

The law introducing appeal by way of re-hearing will come into force on 1 January 2012.

Yuriy Nikolaev of Nikolaev & Partners took the view that in order to cure the judicial system, not only structural reforms will be needed, but the replacement of the majority of the present judges. It is a question of psychology, he said. If a person has been dependent all his life, he cannot take objective decisions. One whole generation of judges must be replaced. And Tamara Morshchakova, former Deputy Chairman of the Constitutional Court, and a formidable commentator, pointed out on *Pravo.ru* on 24 February 2010 that the task of reform is formidable. If a judge seeks to oppose the other state powers, she is simply "eaten up". To this day, Russian judges are not separated from the other organs of state power, and judicial independence is simply not guaranteed.

Are the proposed reforms simply PR by Medvedev? There are two recent comparators.

On 18 February 2010 President Medvedev announced what appeared to be a radical reform of the Ministry of the Interior (the police) sacking a number of generals and giving the Minister, Mr Nurgaliyev,

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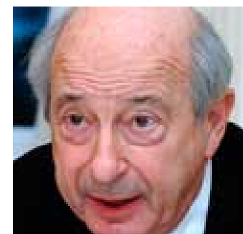
one month to come forward with radical plans. Many commentators were sceptical, seeing these actions as further evidence that Medvedev is escalating his pre-election campaign against Prime Minister Putin, and showing that it is he who controls the "force ministries". And Ilya Barabanov, writing in *"The New Times"* on 22 February 2010, sees this as simply a "clean-up of uniforms". Most of those dismissed were either about to retire or were the subject of scandals.

These changes for the police followed Medvedev's appointment, on 3 August 2009, of Aleksandr Reimer as head of Russia's penitentiary system, FSIN. The death in detention of the lawyer Sergey Magnitskiy was followed by a series of dismissals, and on 19 February 2010 Mr Reimer used unprecedentedly strong language in summing up the results of 2009, accusing his subordinates of lack of system, sloppiness and slackness. But many of those dismissed were in fact reformers, who had made real progress in humanising the system.

In the not too distant future it will be possible to make a firm judgment as to whether Medvedev's proposals are the genuine article, or simply an attempt to position himself to continue as President. ■

China's Future Role on the World Stage



Stanley Crossick is a Senior Fellow at the Brussels Institute of Contemporary China Studies (BICCS). BICCS is part of the Vrije Universiteit Brussel and aims to increase European political, economic, social and cultural understanding of contemporary China; and to be an academic hub between Europe and China. It has 12 experts working on China and also an extensive teaching resource. See www.vub.ac.be/biccs

The world stage is changing fast and China is changing fast. In order to examine China's future role on the world stage, we must first address the ways the world and China are changing.

It can safely be said that no country, whatever its size, can go it entirely alone. Even Donald Rumsfeld, former US Secretary of Defence, told the Council on Foreign Relations in New York on 17 February 2006 that, *"And the reality is, there's practically nothing important that needs to be done in the world that we can do alone."*

The US remains by far the biggest military power, with its spending amounting in 2008 to 40% of the world's (EU 20%, China 8% and Russia 5%). But economic power and influence continues to flow eastwards, increased by the better performance of China and other Asian countries, compared with Western countries, during the financial and economic crisis.

We are therefore seeing both the redistribution of power, but at the same time, deepening interdependence. The world trading system is multilateral and increased protectionism would be disastrous for all. Sustainable development, central to which is coping with climate change, obviously requires close cooperation between countries.

Today's world is one of fast technological change, instant communication, with great uncertainty in the face of major problems, ranging from extensive poverty, increasing disparity between the haves and the have nots, both within and between countries, to the privatisation of weapons of mass destruction and rising international terrorism.

Arguably worst of all is a widespread crisis in governance. Political leadership is lacking: government and the political classes have in many countries lost their credibility in the eyes of the people. Domestic politics widely influences external policies. Short-termism prevails, notwithstanding that the major problems require long-term solutions, but 'pain now, gain later' - after the next election(s) - is not an approach which appeals to politicians.

China is changing fast. The change is economically driven but spills over to all sectors of life. As the Chinese travel more, and more foreigners live in, work in and visit China, and they learn foreign languages, they are inevitably influence culturally, and not necessarily positively: thus with fast food comes obesity…

The growth of internet and mobile telephony has had a dramatic influence on communication at all levels of society. The authorities struggle to control access to information which they prefer to withhold. The extent this will lead to oppression, liberalisation or a sensible balance remains to be seen.

A further unknown is the future influence of the European Union. Will it continue to punch way below its economic strength or eventually get its act together and become a force internationally?

China's current international role

Peter Mandelson, former EU Trade Commissioner and now UK First Secretary of State, concluded a perceptive op-ed in the *International Herald Tribune* of 12 February: *"We all need China to succeed and to start leading."*

Lord Mandelson identifies a mismatch between our expectations of China and China's own assessment of its role and responsibilities. Chinese leadership resents any suggestion that China should or could be dictated to on economic management or anything else. The catastrophic mismanagement that crippled the Western banking system has only deepened scepticism of the superiority of the Western model in China.

Europeans, he wrote, too often don't see that behind China's remarkable economic growth is caution and inhibition born of a governance challenge on a massive scale. On the face of it, Europeans tend to be much more confident of China's inexorable rise than their Chinese counterparts. China's leaders know that the export-led Chinese growth model is not sustainable in the long term, and that weak domestic demand and state-led bank lending need to give way to something more diverse and durable.

Europeans, according to Mandelson, see 10% annual growth as a juggernaut, a tectonic shift in the global economic order. Chinese leaders see it as the minimum required to create the jobs to meet the expectations of its people. We see China as increasingly rich. China sees itself as still, in many respects, worryingly poor.

The deterioration in relations between China and the West is disturbing. Without the PRC, EU and US acting boldly together, there is little hope of solving today's major problems, reforming global governance or achieving, in the words of the Chinese leadership, an harmonious and participatory society.

Chinese perspective

Currently, it is probably more difficult than ever to understand what is happening in Chinese government circles and the resultant policies and inconsistencies. Few people know what goes on in Zhongnanghai. Unlike in other countries, the leadership works and lives together in a single compound which deprives analysts of the benefit of leaks.

The differences between Chinese and Western ways of thinking and their views of the world are often enormous and there is insufficient mutual understanding and trust: misperceptions abound on both sides.

Hu Jintao, at a major internal diplomatic conference in Beijing in July 2009, talked about the four strengths of diplomacy: more political influence; more economic competitiveness; a more positive international image; and greater moral influence. This appeared to be a recognition that China needs the soft power which comes with international respect.

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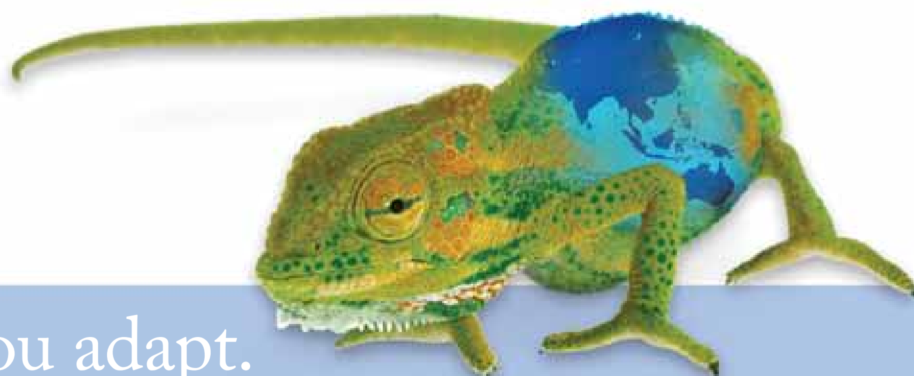
— CHARLES DARWIN



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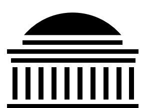

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The "charm offensive", as the *Economist* put it (Banyan, 9 January) seems to be over. During the past few years China has resolved almost all of its border disputes, joined a free trade area with ASEAN, made a substantial contribution to African infrastructure, established hundreds of Confucius institutes, staged the Olympic Games, and generally increased its friendly relationships across the world.

China is showing no flexibility or compromise in negotiations, but insists on getting what it wants. Chinese leaders have become more outspoken publicly and less diplomatic in their tone. Wen Jiabao told Xinhua news agency at the end of last year that China *"will not yield to any pressure of any form forcing us to appreciate"* the value of its currency. Diplomatic niceties seem to have been overlooked in Copenhagen.

Western frustration

There is considerable and growing frustration in the US and Europe that China is not behaving fairly in a number of areas. This perception has led to a deterioration in relations between China and the US, and between China and Europe; and is an obstacle to growth of the country's influence on the world stage. The EU supplies extensive financial and technical support to China but does not feel a spirit of reciprocation.

I fear that Beijing may be underestimating China's vulnerability to a deterioration in economic relations. Chinese behaviour, as perceived, is fuelling protectionist sentiment in other countries. At the same time, the US and the West need to be convinced of the difficulties in the transition for China and not to insist that China adjust faster than it can. The relevant EU, Chinese and US policymakers must cooperate in producing a medium-term coordinated plan to resolve trade and political disputes.

China is resisting further sanctions against Iran. Failure to support full sanctions is resented in the West, particularly as China is substantially investing in the country, despite the nuclear threat. China's reaction will have a serious impact on its international standing, particularly if Russia aligns itself closer to the US and Europe on the issue. Beijing does not like sanctions in principle, possibly influenced by an extensive Washington-led blockade of the country from 1949 to 1964.

China's increased assertiveness is not only towards the West. The claim to the Indian state of Arunachal Pradesh has become more vocal. Japan has expressed concern that China plans to develop the Chunxiao gasfield unilaterally, in breach of the 2008 agreement. Vietnam complains that China has included in its tourist promotion plans the Paracels, which it claims.

China's policy approach to Africa is not altruistic, and no different from the Western approach in the scramble for oil and natural gas. It's aid contribution, focusing on infrastructure has certainly been more valuable to the African countries than the Western policy, which has poured money into Africa but neglected infrastructure building. The Chinese are now, however, encountering some African resentment and violence which need to be addressed. Sino-European cooperation could help.

China's image suffers because of the nature of some of the régimes it deals with (even though they are following in Western footsteps), but the PLA trying to send a shipment of arms to Zimbabwe, while the West was seeking increased sanctions, did nothing for China's reputation.

Sovereignty and non-interference

Chinese foreign policy is substantially influenced by its deep belief in national sovereignty and non-interference in the domestic affairs of other countries. This is understandable. China's humiliation by the West in the 19th and 20th centuries is history to us but to the Chinese it only happened yesterday.

There is, however, a fundamental difference between China and the West on what is foreign interference in domestic affairs. Western countries criticize, and sometimes use pressure on each other, but rarely is this regarded as interference.

China vehemently regards Western leaders meeting the Dalai Lama as interference in Chinese domestic affairs, but it can also be argued that trying to prevent leaders meeting whomsoever they wish on their own territory is domestic interference. The same applies to Beijing's counter-productive efforts to prevent the screening in other countries (eg. the Melbourne and Palm Springs film festivals) of what it regards as hostile films.

The Chinese leadership should now feel confident enough not to regard foreign submissions as interference and non-respect of sovereignty. Foreign and domestic policies are closely interlinked and China expresses its views – rightly so – to the governments of Myanamar, North Korea, Iran, Sudan and the like. Is not this foreign interference according to the Chinese definition?

Europe and the US want China to take a global leadership role. Effective multilateralism requires Chinese involvement. No major global challenge can successfully be met without China. China is reluctant to do so, probably for a number of reasons. Leadership requires sides sometimes to be taken, but China prefers to remain in favour with other countries and not to risk any negative effect of taking sides.

Due to the financial and economic crisis, China has been catapulted unexpectedly early into a global leadership role, for which it is not yet fully prepared. Chinese leadership sometimes seems to be overconfident and sometimes unsure of itself.

China-US relations

Hitherto, the Obama administration has been conciliatory towards China: not branding China a "currency manipulator", playing down human rights issues, softening criticism of government policies in Tibet and Xinjiang. President Obama was seriously criticized for his malleability during his visit to China and refusing to see the Dalai Lama beforehand.

However, this policy does not appear to have earned any dividend. What exactly happened at the Copenhagen UN conference remains unclear, but it seems to show that Beijing's priority remains its own economic development with far less regard for climate change. The Chinese behaviour certainly upset the Americans (as well as the Europeans).

Current China-US relations are worrying. We have witnessed problems such as the uncomfortably Obama visit, reciprocal anti-dumping measures, Copenhagen, the Palm Springs Film Festival , Google and now the Taiwan arms sale. Ahead are the Dalai Lama visit to Washington, increasing concern in Congress over Chinese imports, the undervalued RMB and Iran sanctions.

All these are reflected in a deterioration in public rhetoric with some aggression being detected on both sides. There is a serious danger of growing protectionism which would be an all-round disaster. The unprecedented decline in US self-confidence can have negative consequences.

We really need a trilateral relationship but this is not yet feasible. Closer coordination between the three bilateral relationships would be a start. The EU can play an important moderating influence on both sides, if it can speak with one voice.

Conclusion

Beijing has clearly become more assertive in foreign policy both in tone and on substance. The EU has been treated in a manner which could be described as contemptuous, by the way it has been punished for its member state leaders meeting the Dalai Lama, even to the extent of cancelling a summit. A surprising lack of diplomacy was shown in Copenhagen.

Why is there an increase in assertiveness? There are no doubt a number of reasons. It is only natural for a country which has performed so well in the economic and financial crisis compared with the developed countries, to feel confident and show it through assertiveness. It is also hard to resist an opportunity to turn the tables on past Western

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patronizing lectures. However, a mature and confident power should not need to do this.

Foreign policy attitudes are almost invariably influenced by domestic considerations. The legitimacy of the Party depends on economic growth, made more difficult by the global economic problems and the need for growth to be sustainable.

The conventional wisdom was that, once China became more integrated globally, it would work towards a multilateral world by playing a constructive role in working together with the developed world to meet common challenges. This would strengthen its relations with the US, Europe and others, important for its own progress. However, it seems that a successful China prefers to become more assertive and less committed to flexibility and compromise in negotiations.

My worry is whether the Chinese leadership fully understands the dangers of its apparent policy in international relations. Attitudes towards China are hardening, particularly in the US. Obama's weakened position vis-à-vis Congress will not help. The chances of the US declaring China a "currency manipulator" are increasing. This would add to the protectionist measures already being taken in the anti-dumping field.

If protectionism substantially increases in America, it will spread to Europe, where its leaders are becoming more critical of Beijing and resent the way they have been treated. The 'anti-China' lobbies, in the West (Taiwan, Tibet, Xinjiang, human rights…) will lend their weight to events, particularly in the light of China's poor international standing.

China does not have any true friends in the West. While it is better to be feared than loved, it is desirable also to be loved.

Deng Xiaoping's axiom *"Keep a cool head and maintain a low profile. Never take the lead - but aim to do something big"*, is no longer the rule. We knew from the Diplomatic Conference in July 2009 in Beijing that the axiom had been modified, but the revised wording has not been published – an interesting omission.

China's future international role

The West expects China to accept greater responsibility for global affairs - to be a "responsible stakeholder". But for this to happen, the system of global governance cannot remain entirely western in concept with the West – particularly the EU – overrepresented

The current leadership ends in 2012. The major policy decisions governing foreign policy and China's international role will be determined by the Fifth generation and probably Sixth generation of leadership. The present leadership is unlikely fundamentally to change course. The future leaders will come from a generation not scarred in the same way as the present ones by the Mao époque and the Cultural Revolution. They are much more likely to have travelled abroad, even studies abroad, and able to speak a foreign language. These factors will substantially influence their thinking, but it is premature to forecast in what way. It is hoped that they will be more internationalist and comfortable with the West.

Hu Jintao's four strengths of diplomacy: more political influence; more economic competitiveness; a more positive international image; and greater moral influence, have a long way to go. ■

India's Urbanization: A Trade and Investment Opportunity

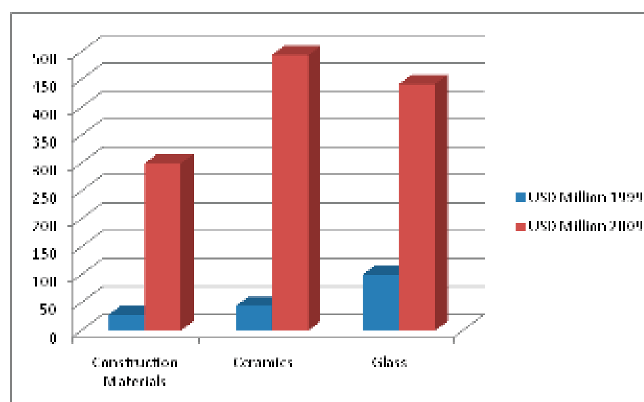
Pritam Banerjee is the Head of Trade and International Policy at the Confederation of Indian Industry

As India's economy continues to grow, and as services and manufacturing employs an increasingly larger share of India' workforce, rapid urbanization has begun to take place. This move from villages to India's cities has not received the focused attention of the international trade and business community in terms of the opportunity it presents to global businesses. Consider the scale of transformation; it is estimated that India's urban population will increase from the current 300 million to about 520 million by 2020. This essentially means that India will add 220 million new urban residents in the next ten years which is more than the entire population of a large country like Brazil. India's current urban infrastructure needs to expand several times to just meet current requirements in terms of providing services, housing and transport to its urban citizens. If one adds the demands that would be made to develop the additional capacity to absorb new urban citizens in the next ten years one can start seeing the scale of investment, services, and materials required to address India's urbanization needs.

The four key areas where international participation, whether through the movement of materials and goods, services, or investment would be critical to meet India's needs are mass rapid urban transport, housing, waste management, and environmental services. India's federal ministry for urban development as well as the state level urban development authorities has already ear-marked large sums of money for investment in these areas. The Jawaharlal Nehru National Urban Renewal Mission (JNURRM) have a budget USD 20 billion for addressing various issues related to urban transport and sustainable waste management. The Rail India Technical and Engineering Services (RITES), a leading Indian public sector transport specialist has estimated that developing mass rapid urban transport in India would require an investment of approximately USD 50 billion by 2020. Development of new townships and of better housing would involve investments of over 100 billion USD. According to some forecasts 31 million new homes will required in India by 2015. This only represents the tip of the iceberg as experts point out that the housing loans and mortgages market is still from fully developed and it is yet reach out effectively to India's 124 million lower-middle income households and develop a market for low-cost housing finance.

So what does this mean in terms of trade and investment opportunities for businesses across the world? In short, even if we assume that only 20% of the demand for goods and services required for India's urban development in the next decade will be sourced from outside it represents a 40 billion USD market. It would be useful to look at:

Table 1. Imports of construction materials (HS 68), ceramics (HS 69), and glass (HS 70) in 2009 compared to 1999



Source: Ministry of Commerce, India

MAZOVIA'S Great potential

About Mazovia

Mazovia is the best known Polish district which popularity is based first of all on being the biggest and centrally situated region in the country hence it has easily become an economic leader. Due to its central location, large and absorbent market (more than 5 million inhabitants) which constantly improves as well as its educated and qualified population, Mazovia tends to perform as the most frequently picked up region by overseas investors. Almost 30% of the largest foreign investments are settled exactly here and one of the main reasons of that is the central localization at the crossroads of trade routes, thanks to which Mazovia nowdays is a promising district and has the greatest chances to become an important and equal region in the entire European Union.

Mazovia is the fastest growing voivodeship in Poland that exploits the changes most effectively and is the place where all the economic dynamic transformations of the last decade are visibly seen. Promptly taking an intended advantage of these transformations led Mazovia to position of the economic and change leader among Polish regions. In no other region in the whole country changes went so instantly and so successfully. Mazovia's high in various ways attractiveness beats other regions of Poland and at the same time it draws numerous foreign tourists what makes this region the most visited in Poland. This fact is highly significant to Mazovia's economy (about 5 million people annually, almost 30% of the total number of visitors to Poland).

Mazovia is the voivodeship with a commonly known great history, stunning monuments and of course the immense economic potential and above all – it permanently gets more and more well-prepared to play a significant role among European regions.

Poland, the country situated in the very heart of Europe, is the main beneficiary of foreign direct investments (FDI) in Central Europe: in years 2006, 2007 and 2008 an average FDI worth around EUR 14,4 billion. According to the Polish Agency for Foreign Investments (PAIZ) the most important factors which incline investors to choose Poland as an investment location are the size and absorbency of the market (nearly 40 million inhabitants - the largest country in central Europe), the low labour costs (one of the lowest on the continent), favourable business environment, growing integration with the worldwide economy and the success of Polish privatization. Over 70% of the capital invested in Poland comes from European companies.

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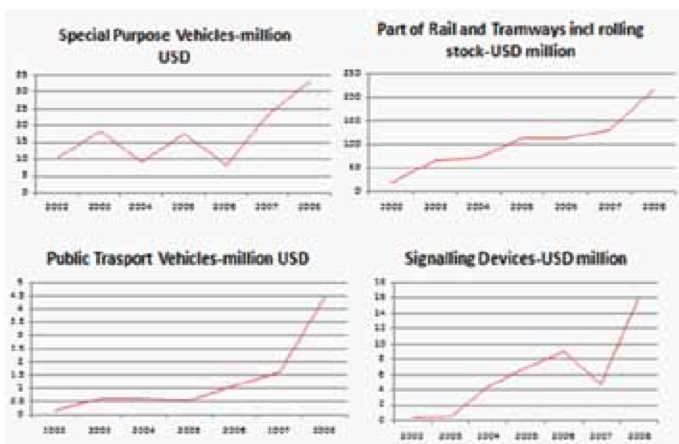
e-mail: coi@armsa.pl
www.armsa.eu, www.mazovia.pl

Table 2: Imports of Machinery and Stock related to Urban and Mass rapid transport



Source: UNCTAD (intracen.org)

Housing

The scale of growth in terms of imports related to housing and construction in India in the last ten years have been phenomenal.

India's annual imports for construction materials and ceramics have grown by over ten-times, and given the nature of India's urban development is likely to increase several times more in the coming decade. But it is not just imports of materials that present an opportunity; there will demand for new types of hybrid construction material, new building techniques and engineering services, and advanced architectural services the domestic capacity for all of which is currently very low in India and the country would look outwards to source such technologies and services.

Mass rapid urban transport

Given the already problematic state of traffic jams and growing urban sprawl, urban mass rapid transport has become a necessity. This is especially true for some of the larger metropolitan centres. Table 2 below shows the rising trends in demand for various components of transport machinery relevant to urban transport. While the base remains low, for example imports of special purpose vehicles in 2008 was just over USD 30 million, the increasing sophistication of India urban transport needs would mean that a lot of the machinery and materials would not have a domestic supplier and would thus we entirely imported. It would also give rise to FDI as MNC manufacturers look to build capacity in India to serve a rapidly expanding foreign market. A good example is Volvo, whose buses are becoming an increasingly common sight on Indian roads.

Waste management

The demand for better and more efficient waste management technologies, plant and machinery would be led by two factors, the growing population in urban areas and the increasing need felt for a better quality of life in terms of cleanliness and environmental outcomes in cities. Traditional systems in operation in most Indian cities will be phased out. Modern waste management systems that also recycles waste will become the norm and this will have to involve the importation of machinery that sorts waste, identifies hazardous materials, provides recycling processes etc.

Environmental technology

Since India has set itself voluntary emission standards for compliance and is increasingly more committed to sustainable development, Indian entrepreneurs will have to start investing in various technologies that reduces emissions, decreases waste, and recycles resources. One big area of development especially in the context of industrial-urban complexes is the management of waste water, which is also intimately linked to other critical issues in India, keeping its rivers clean and ensuring the water security of a billion plus people in the years to come. Cutting edge technologies in industrial waste water management is available in Europe and other industrial economies and as such India represents a very big business opportunity for them.

Professional services

While machinery and technology are one aspect of the demand from India, services in the form of management of complex systems and technology implementation represents the other part of the picture. Given India's relative lack of experience in dealing with highly sophisticated urban systems, a core group of professionals will find employment opportunities in India as managers and technicians, especially in the next ten to fifteen years, ie. the time it will take India to scale up its own professional base in these niche areas. Thus foreign firms in environmental, waste management, and transport services will find good business opportunities in the coming years.

It is a rare case where a large sophisticated economy like India lacks domestic capacity across a large spectrum of goods and services, and such goods and services are an absolute necessity for its own sustainable growth. The goods and services connected to the urbanization challenge represent such a rare case and is therefore such a great opportunity for external suppliers. The firms that will do their market research earliest and move in with a first mover advantage will find their investment more than worthwhile. ■

Austria - The Centre of Europe

Dr Jürgen Brandstätter, Managing Partner of BMA Brandstätter Rechtsanwälte GmbH, Vienna, Austria, in a Q&A with WorldCommerce Review's Tom Page, explains the legal and tax benefits of locating in Austria and the dangers of European Union over-regulation

In his role as Managing Partner of BMA Brandstätter Rechtsanwälte GmbH, Jürgen Brandstätter leads the firm in successfully advising renowned businesses, including major global players, on their Austrian legal requirements.

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What legal steps are required when locating in Austria?

If a person intends to settle in Austria, one has to differentiate between whether the person is a citizen of a member state of the European Union or of a third country. In case he is from a European member state, he may take up residence and even employment without the need of a special permission due to the freedom of establishment and services in the European Union. However, citizens of third countries do need special residency and work permissions granted by administrative agencies. In some cases it might prove difficult to attain such permissions. The incorporation of a legal entity, be it a limited liability company, be it a joint stock company may be done in Austria without the need of a special permit. In this case it does not

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matter if this is done by EU- or third country citizens.

The same applies to foreign companies, either from within the European Union or from outside who want to incorporate a subsidiary in Austria. The only thing to remember is to observe the different requirements for the different legal entities. However, the statutory requirements make no difference between Austrians and foreigners but are equally applicable to both. It is therefore not necessary that legal entities, whose shareholders are non-Austrian, be it natural persons or foreign legal entities, to take in Austrian shareholders or hire Austrian citizens as directors. In Austria, legal entities may be owned entirely by foreigners and foreigners may, even if they have not taken up residence in Austria, become directors of such legal entities.

What benefits from a legal and tax perspective does locating in Austria provide?
A well organized court system ensures the rule of law principles. Austria is also far advanced in the area of e-government. Company registration can and must be performed electronically, as well as tax statements. Company and land registers may also be viewed publicly through the internet. For business activities, the Austrian legal framework, offers in particular legal forms of joint stock company, limited liability company, general partnership and limited partnership. Corporate income tax is, with a flat rate of 25%, reasonable.

"The European Union, as an economic union, is in competition with other large economic areas of the world like North America or Asia. When passing laws, the European Union has to keep in mind the effect this will have on the global competitiveness of the European Union"

Austria is in particular interesting as a place for a holding company since it has concluded double taxation agreements with more than 80 countries which follow the OECD model agreement. Corporate income tax offers the international participation exemption, according to which dividends which are gained from a subsidiary of which the mother company owns at least a 10% share for an uninterrupted period of one year, are tax free for the Austrian holding company. Austrian tax law also knows the system of group taxation according to which the Austrian holding company may deduct losses by foreign subsidiaries from the taxable income of the Austrian holding company.

What special employment regulations apply in Austria?
Austrian employment regulations are mostly similar to employment laws in other European Union member states. From an employer's point of view, regulations are still more liberal than in some of the bigger European member states. In particular regulations regarding employment contract termination are not as strict as in Germany or Italy.

What effect has SEPA had on Austrian trade and investment?
SEPA makes monetary transactions easier. SEPA means that payments made in euro from one member state of the European Union to another, will be treated as domestic money transfers by the banking sector. This means in fact that domestic money transfer fees apply and that transfers now have to be done in three days, to be reduced to one day in the year 2012. This helps trade in particular, since this sector of the economy uses and needs liberal transfer regulation the most. With regard to investments in Austria, SEPA makes Austria as good an investment place as any other European member state that has the euro as its currency. Hence, a level-playing-field exists.

How will the Euro Single Payment Area (SEPA) evolve in Austria?
The implementation of the legal and technical changes accompanying SEPA is almost complete in Austria. In particular the new payment instruments, introduced by SEPA, have already been made available by the banks to the customers. Money transfers abroad may already be done exactly like money transfers within Austria using BIC- and IBAN-code of the recipient of the payment. The transformation of the data processing systems of the various banks, to enable them to process cross border transactions which are treated like domestic payments, is almost completed.

How does the Austrian legal system differ from other member states?
Austria is a civil law country and is therefore in its legal structure fundamentally different from a country such as Great Britain which is a common law country. For centuries Austria has had a well functioning legal system which has continuously been adapted to suit modern day demands. The Austrian legislator is pretty fast in implementing laws passed by the European Union into national Austrian law.

How would you describe the effects of European law on member states and their ability to attract investment?
The European Union, as an economic union, is in competition with other large economic areas of the world like North America or Asia. When passing laws, the European Union has to keep in mind the effect this will have on the global competitiveness of the European Union with regard to the above mentioned regions and thus the effect they will have on each European Union member state and its ability to attract investments from outside Europe.

Would you describe regulation as light touch?
The European Union has to be very careful, in particular when responding to the economic developments of the last two years and the resulting problems, not to try to solve the latter by overregulation. The economic problems of the last couple of years are caused by the partly distorted economic structures of the member states of the European Union, in particular its welfare system and its demographic problems. These problems will not be solved by over-regulating entire sectors of the economy, like the banking sector.

What legal pitfalls affect corporations and how can you help?
The potential legal pitfalls affecting corporations are so numerous that they might not be described in the course of a short interview such as this. It is a fact that companies today must be particularly careful to observe those regulations ruling the marketing of their products and services. There are virtually no areas left in business where marketing of products or services may be done without being subject to regulation.

Whether it is cars, the advice when selling financial products or medical services, in all these areas regulations have to be observed. In case these regulations have not been observed and the customer is unhappy or harmed in other ways by the product or services, the company is threatened with potential damage claims. It is the attorney's job to identify for the enterprises as well as their products and services the relevant laws and help them to first apply and then abide by the law.

How would you anticipate the development of the legal environment?
One cannot help but fear that the governing body of law will all in all become even more complex than it already is. The influence of heterogeneous interest groups in society on the legislative process adds an additional dimension of complexity on the legal system. ■

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Regulating Bank Systemic Risk: Essential Macroprudential Supervision

Moorad Choudhry is the Head of Treasury at Europe Arab Bank plc, London

The successful prosecution of commerce in society requires that there exist institutions that can act as conduits through which capital is exchanged. In this regard, it is important to remember that there is nothing inherently "bad" about borrowing money, just as there is nothing intrinsically "good" about saving. They are two sides of the same coin: if everyone was a saver, then banks would not exist because there would be no point in paying interest on deposits. Equally, borrowers could not exist without savers. It is the ultimate symbiotic relationship, and essential to continuous development and progress in society.

The art of banking remains unchanged since banks were first established. At its core are the two principles of asset-liability mismatch and liquidity management. The act of undertaking loans and deposits creates the mismatch, because while investors like to lend for as short a term as possible, borrowers prefer to borrow for as long a term as possible. This gives rise to liquidity risk, and bankers are therefore required to take steps to ensure that liquidity, the ability to rollover funding of long-dated loans, is continuously available.

The fact that all banks irrespective of their size, approach, or strategy must manage these two basic principles means that they are, ultimately, identical institutions. They deal within the same markets and with each other. That means that the bankruptcy of any one bank, while serious for its customers and creditors, can have a bigger impact still on the wider economy because of the risk this poses to other banks. It is this systemic risk that was the biggest danger for the world's economies in 2008, after Lehman Brothers collapsed, and which now presents the biggest challenge for financial regulators worldwide. In this article, we examine the nature of bank systemic risk, and present suggestions as to how to manage it most effectively.

Systemic risk: defining systemic importance

That banks are vital to the wellbeing of the wider economy is evident from the reaction of western governments to the crisis following the collapse of US firms AIG and Lehman Brothers. Banks such as Citibank, Royal Bank of Scotland, UBS and KBC Bank were partly nationalised and/or received large cash injections from their governments. These were the institutions deemed "too big to fail" (TBTF), and whose bankruptcy, it was rightly viewed, would have been catastrophic for the world economy because of the high systemic risk such bankruptcy represented.

This poses the question as to exactly which banks are systemically risky. Is it only large banks that present systemic risk? Prior to September 2008 the experience of Bear Stearns in the USA and Northern Rock in the UK had shown that banks not necessarily defined as TBTF can still create significant market turbulence when they fail. What has become clear is that in a globalised economy with many interconnections, the collapse of almost any bank, and certainly any bank with cross-border interests, can destabilise the economy to a ruinous extent. Banks must not only know their risk, they also need to assess the risk exposure of their counterparties. The events of 2007-08 have demonstrated conclusively that it is not sufficient that banks manage their own risks adaquately, they also have to be aware of the potential risk exposure of their counterparties. Bear Stearns, for example, had large exposure to hedge funds that had invested in low-grade assets.

The UK's Financial Services Authority (FSA) has suggested that a firm be defined as systemically important in the following way:

> *"…when its collapse would impair the provision of credit and financial services to the market with significant negative consequences for the real economy."*[1]

The precise definition of systemic importance is no longer purely a reflection of the size of the bank. The FSA view of the factors that make firms systemically important is as follows:

- systemic by size: the absolute size of the banks is relevant, but so is its size relative to a particular financial market or product;
- systemic by interconnection: the importance of the firm to the interbank market and clearing systems;
- systemic by association: where the market views one company as representative of a group, whereupon failure by one is seen as a potential failure by all (an example would be the UK building society sector).

The above is a logical approach. However, it remains the judgement of financial regulators to determine the extent to which a particular firm falls into one or more of the three categories and can be specified as systemically important. For maximum risk mitigation we believe it desirable to minimise the amount of judgement required. In this regard there is a strong case for suggesting that almost all banks fall into at least the last category above, making virtually all banks potential areas of material systemic risk. If we accept this, then there are significant implications for bank supervisory authorities.

Macroprudential regulation

The events of 2007-08 demonstrated clearly how the failure of one bank can have significant implications for other banks as well as the entire market. At their heart, banks are identical beasts. Large numbers of them operate in the same markets, with the same customers and with each other. It is this interconnection that means that when one bank fails, the entire industry (and by extension the economy) is at risk. Hence it is not sufficient for financial regulators to aim to ensure that each bank is properly managed and has sufficient capital and liquidity arrangements in place. They also have to oversee the soundness of the industry as a whole. Thus "macroprudential" regulation is now the main focus for bank regulators.

The framework within which macroprudential regulation would be undertaken remains under discussion.[2] The broad objective of such regulation is to ensure the continued safe running of the financial system in the event of individual bank failure. A number of steps can be taken by regulators to assist with this.

In the first instance, bank business activity must be proscribed by regulators to the extent that it becomes less cyclical, or less susceptible to the ill-disciplines of a bull market. When the economy is growing steadily and risk aversion is decreasing, banks fall into a pattern of lowering loan origination standards and easing the supply of credit. A booming economy and tightening credit spreads alter bank risk-taking behaviour. Not only do they lower their origination standards, often banks' strategy is changed to the extent that market share and higher return-on-equity (RoE) targets become more important than sound liquidity and capital management. This was the error made by UK banks such as Northern Rock, Bradford & Bingley and HBOS.[3]

Because they act almost as one, this cyclical pattern is exacerbated during any significant market event. The supply of plentiful and cheap credit helps boost the price of assets such as equities and real estate. At the end of the cycle and in a recession, banks then as a group withdraw credit on a large scale, widening the impact of the recession and also causing a fall in asset prices.

The first requirement in macroprudential regulation therefore is for banks to operate in less cyclical a manner. This can be enforced by

Figure 1. Selected banks size, capital and leverage as at 31 Dec 2008, amounts in EUR

Bank	2002	2003	2004	2005	2006	2007	2008
Citigroup							
Total Assets	1,097,190	1,264,032	1,484,101	1,494,037	1,884,318	2,187,480	1,938,470
Financial Leverage	13.02	12.96	13.4	13.56	14.68	17.53	22.37
Tier 1 / Core capital	8.47	8.91	8.74	8.79	8.59	7.12	11.92
Royal Bank of Scotland							
Total Assets	412,000	454,428	588,122	776,827	871,432	1,840,829	2,401,652
Financial Leverage	17.04	18.55	18.26	19.68	21.78	29.08	37.91
Tier 1 / Core capital	7.30	7.40	7.00	7.60	7.50	7.30	10.00
UBS							
Total Assets	1,181,118	1,386,000	1,737,118	2,058,348	2,396,511	2,274,891	2,014,815
Financial Leverage	29.5	34.49	45.01	48.69	47.54	53.97	61.81
Tier 1 / Core capital	11.30	11.80	11.90	12.80	11.90	9.10	11.00
KBC Group							
Total Assets	221,730	225,586	285,163	325,801	325,400	355,597	355,317
Financial Leverage	28.16	25.45	23.78	21.76	19.86	19.81	22.53
Tier 1 / Core capital	8.83	9.54	10.07	9.40	8.70	7.40	7.20
GDP values (EUR millions)							
USA							10,145,944
UK							1,889,709
Switzerland							348,907
Belgium							355,418

Source: Bloomberg LP, World Bank

altering bank capital and liquidity requirements. At any time when the market is viewed as pursuing ever more risky asset generation, and/or credit is seen as too easily available, the regulator can require banks to:

- increase their level of capital, particularly Tier 1 equity capital;
- adjust their liquidity ratio to ensure that there is less reliance on short-term funding and wholesale interbank funding.[4]

Both of these steps would increase the cost of doing business for a bank, and thereby lead to decreased lending levels during a boom period.

The difficulty of course is the judgement call of when exactly a bull market is underway, or the precise moment when a market is, to borrow an earlier phrase, irrationally exuberant. While it is easy to see in hindsight at what point a market crash began, it is harder to call such an event beforehand. Measures that regulators may wish to consider include:

- the overall level of lending in the economy, both as an absolute level and as a percentage of GDP;
- the rate of increase in retail lending, for example credit card and residential mortgage approvals, as well as the rate of increase in lower-credit-quality lending;
- the rates of return on equity on bank capital, and whether this is running at above long-run averages;

In practice the regulator may wish to use a combination of these measures when making this assessment, which will always remain a judgement call. The regulators also need to monitor aggregate economic indicators such as the rate of growth of GDP and asset prices, compared to medium-term average rates.

The Bank of England has suggested that particular types of loan activity need to be targeted when capital requirements are raised.[5] Otherwise, there is the risk that banks will merely pull back from lower-risk business lines and use the capital saving created to continue business in higher-risk activity. This is logical, and we would suggest that it may be addressed by focusing – not at the macroprudential level but at the direct individual bank level – on RoE targets and leverage levels. If regulators place limits on these two values, and alter them to suit the business cycle, this will also drive more counter-cyclical behaviour. What is clear is that a reliance on higher capital requirements alone would not be a sufficient safeguard against systemic risk, because one could never know how much capital was enough.[6]

The liquidity ratio for a bank is a key risk measure and regulators can use it to influence macroprudential behaviour. By setting a more conservative liquidity ratio requirement for banks that run large asset-liability gaps, and therefore greater liquidity risk, the regulator can ensure that asset origination cannot exceed by too much the ability of the bank to fund such assets more robustly.

At the micro level, banks should be required to issue and hold co-called "contingent capital", which is long-dated debt that can be converted to equity in the event that the Tier 1 capital ratio falls below a (pre-specified) level.

Of course, notwithstanding our view that essentially all banks pose a systemic risk of some sort, the larger multi-national banks need yet more stringent treatment. They should be forced by their home regulator to ensure that their overseas operations are separately capitalised and liquidity self-sufficient. This would ensure that economic crises in one country were not imported into another via the banking system. By the same token, each legal entity in a banking group would be required to set up a "living will" so that it could be easily and safely unwound without affecting the capital base of the rest of the group.

In this last regard, the requirement to have separately capitalised trading and retail divisions would also be beneficial. A large group entity that relies on the central bank "Lender of Last Resort" is a direct risk to the taxpayer, and its failure has significant impact. The best examples of this were Citibank, RBS, KBC Bank and UBS in the US, UK, Belgium and Switzerland respectively, during 2008. Figure 1 demonstrates the growth in size, leverage and potential risk of these banks in the build-up to the Lehman bankruptcy, following which they all had to be bailed out by their governments. We can observe the steadily increasing risk exposure, particularly with regard to leverage ratios. In the case of UBS, the bank's balance sheet had exceeded the size of its home country's GDP.

If a banking group's risk-taking arm gets into difficulties, in theory if it is a separately capitalised entity it can be unwound or allowed fail without endangering the retail banking arm. Its subsidiarisation would also enforce funding discipline as lenders would lend to it at a premium over the parent entity funding rate. We therefore recommend that the trading arm be a separate subsidiary with its own capital base.

Recommended policy approach

Effective macroprudential regulation requires that banks also take specific measures as part of the effort to maintain systemic stability. Current best-practice thinking is for measures along the following lines:

- reducing market exposure to large "systemically important" banks by requiring them to trade a larger proportion of their trades via a centralised clearing system. This would reduce contagion across the market when one bank failed, as a central clearing house reduces bilateral counterparty risk;
- the trading arms of all banks should be required to hold more capital than the retail arm. This is expected in a new Basel III regulatory capital regime;
- requiring a higher capital ratio for large banks;
- as part of the "Living Will" arrangement, putting in place alternative solutions to the rescue of a complete banking group, and thereby allowing parts of it to fail. This recommendation can be better enforced if group entities separately capitalise their risk-trading arms into different subsidiaries, as discussed earlier in this article;
- cross-border stability arrangements: given that uniform arrangements worldwide are unlikely to be implemented, current thinking is that the home country of a banking group structured across subsidiaries in different national jurisdictions should not be responsible for saving the whole group. The

practical impact of this is that subsidiaries must be "stand-alone" entities, both capital and liquidity self-sufficient, and which could be allowed to fail without endangering the entire group.

Tougher macroprudential as well as micro-level regulation is vital if financial market stability is to be ensured at the time of the next crash, more so because the nature and size of the next crunch cannot be estimated with any certainty. At the micro level, systemic risk will be mitigated further by requiring all banks to adhere to a more stringent capital and liquidity regime, and one that has a counter-cyclical emphasis. Although both of these requirements will increase the cost of doing business, and thus reduce lending volumes in the long run, this is a desirable result because we wish to both reduce the ability for a bank to grow rapidly during a bull market as well as reduce the need for it to cut lending during a recession. In other words, counter-cyclical behaviour must be enforced by regulatory fiat, rather than left to the prudence and discretion of individual banks.

Conclusions

The 2007-2008 financial crash and recession, and its aftermath, demonstrated that the banking system plays a vital role in the well-being of the world's economy. This places the industry outside the realm of a purely private free enterprise, because of the significant impact of individual failure on the wider economy. Therefore it is important to ensure adequate macroprudential regulation, enforced by the central authorities, to ensure the stability of the banking sector throughout the business cycle.

The key to efficient macroprudential regulatory oversight is to require banks to follow counter-cyclical behaviour with regard to capital, liquidity and loan origination. In addition, infrastructure must be enhanced to reduce the level of interconnectivity in the system, via centralised clearing houses. This would reduce counterparty risk and lower the impact of bank failures. Ultimately, only a sea-change in the strategy and approach of banks, with emphasis on more sustainable return targets and lower leverage, may be required before the financial system can guarantee continuous stability.

Moorad Choudhry is editor of the *EAB Treasury Morning Shout* on www.eabplc.com and author of *Bank Asset and Liability Management*, published by John Wiley & Sons (Asia) Pte Ltd. ■

1. FSA, Policy Statement 09/16, October 2009
2. For example, see Bank of England, The role of macroprudential policy, November 2009
3. It is noteworthy that the Chief Executive Officers of the last two firms had backgrounds in retail and not banking.
4. The liquidity ratio is essentially the asset-liability "gap". A good idea of this gap can be determined by calculating the ratio of average maturity of assets to average maturity of liabilities. A higher ratio is indicative of a higher gap and higher liquidity or funding rollover risk.
5. Ibid
6. Lehman Brothers was capitalised at 11% at the time of its collapse, a level that was perfectly acceptable to regulatory authorities while it was still in operation.

Costa Rica Is Endeavouring To Lose Its Reputation as a Tax Haven

Carolina Flores is a Partner at Arias & Muñoz Costa Rica. She is in charge of the Tax Department

Introduction

In February, 2010 - but expected since December 2009 - the Government of France published its list of tax havens, which includes Costa Rica. The list corresponds to a reform of French law approved on December 30, 2009 and is based on the Organization for Economic Co-operation and Development's (OECD) list of non-cooperating jurisdictions in the field of exchange of tax information.

The reasons that have been cited for including Costa Rica on the issued list of countries that OECD and France consider tax havens are Costa Rica's perceived non-collaboration in the provision of banking information for tax purposes because of its protection of bank secrecy and the difficulty third parties face in obtaining information related with bank accounts. However, Costa Rica, in an effort to have itself removed from this OECD list, has been carefully analyzing the situation in the months since the G20 summit in London in April 2009.

The risk for Costa Rica being included in these types of lists lies in the possibility that any foreign entity with operations within Costa Rica could be subject to higher tax rates in its country of origin. As an example, under the French tax reform any French taxpayer who obtains profits in Costa Rica is subject to a 50% income tax rate on these profits. Furthermore, according to the G20 statement issued in London on April 2009, sanctions could include both closing the flow of resources from international cooperation and not allowing sanctioned countries to receive differentiated treatment from multilateral banks in the financing of development activities.

What constitutes a tax haven?

According to the OECD there are four key factors used to determine if a given jurisdiction is a tax haven:

1. Whether the jurisdiction either does not impose taxes or the ones imposed are just nominal.

However, if there are no direct taxes, but there are indirect taxes the other three criteria are used to determine if we are dealing with a tax haven.

2. Whether it is possible for non-residents to benefit from tax cuts even if they are not active in the country.

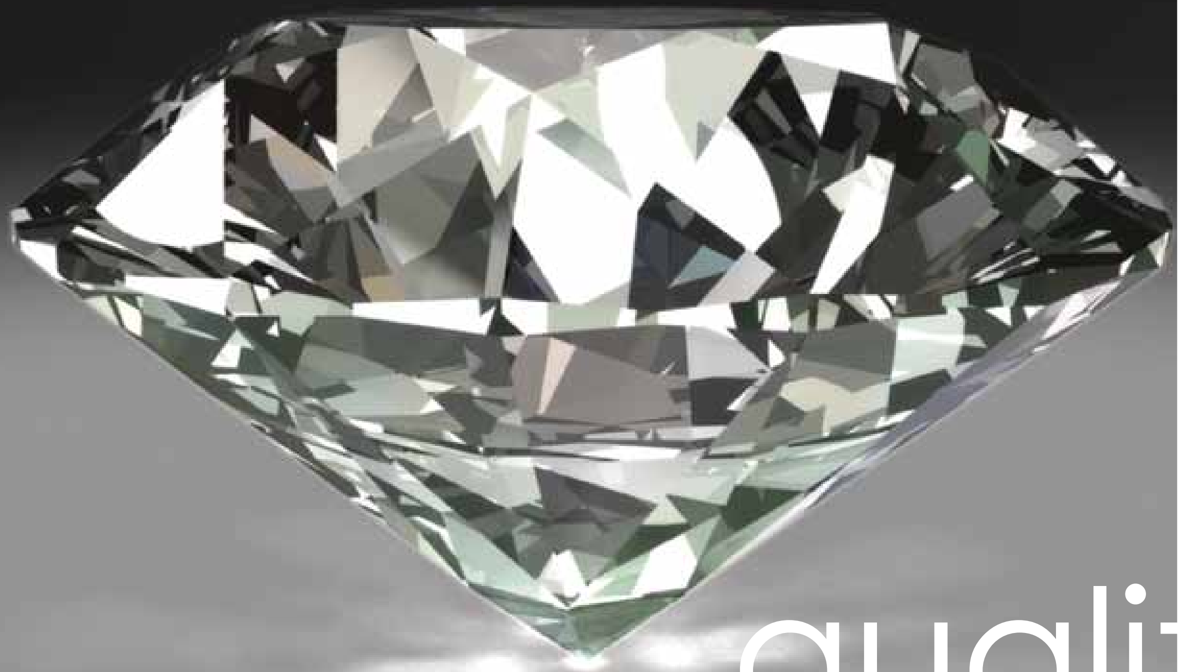
3. Whether there is a lack of transparency.

4. Whether the laws or the administrative practices disallow the exchange of information for tax purposes with other countries in relation to taxpayers who benefit from low taxes.

The OECD has developed standards of transparency and exchange of information that require:

- Exchange of information on request where it is ¨foreseeably relevant¨ to the administration
- No restrictions on exchange due to bank secrecy or local tax requirements
- Availability of reliable information and the possibility for obtaining such information
- Respect for taxpayers´ rights
- Confidentiality of exchanged information

A common characteristic of tax havens is that there are usually two parallel and different tax regimes. These are tax regimes that: (1) applies to residents and local companies and (2) applies to non-residents who enjoy tax advantages, but are disallowed from having any business activity in the country. Another typical characteristic of tax havens is the presence of strict bank secrecy and personal data protection laws. The personal information of a board of directors and shareholders is normally hidden under the person of the "registered agent".



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Does Costa Rica constitute a tax haven?

Let's review Costa Rica against the criteria described above:

1. Income from Costa Rican sources consists of income derived from: services rendered, capital used, and properties located in Costa Rica. Corporations obtaining Costa Rican source income are generally subject to a 30% income tax rate. Moreover, upon distribution of dividends to its shareholders, corporations must withhold 15% on such dividends, except when distributions are made to Costa Rican corporations and companies.

2. Costa Rican source income paid to recipients domiciled abroad is subject to a withholding tax in Costa Rica. The applicable rate depends on the type of income, as follows: a) interest: 15%; b) income from production, distribution or other activities related to movie or television films or videotapes: 20%; c) salaries: 10%; d) commissions or any work compensation: 15%; e) dividends: 15%; f) technical, financial, administrative or similar advice: 25%; g) patents, trademarks, franchises, and royalties: 25%; h) compensation to company directors: 15%; and h) any other income remitted abroad: 30%.

3. Under local law, Costa Rica's Tax Authorities may access local bank accounts only when it suspects tax evasion and when a judge authorizes the opening of the bank accounts.

4. Costa Rica has never entered into any Double Taxation Treaties and has only entered into one Exchange of Information Treaty (with the United States of America).

From this analysis we can conclude that Costa Rica fails the test not because of low tax rates or because of offering tax cuts to non-residents, but because of transparency and exchange of information issues.

Development of the standards of transparency and exchange of information

The OECD is the international organization in charge of tax cooperation and has been working on the issues of tax transparency and exchange of information for the past 15 years. In 2008, however, it became evident that these two issues were now high on the political agenda, and G20 leaders even affirmed that the era of bank secrecy was over.

In 2009 more progress was made in this field. During the G20 summit held in London on April 2, 2009, all key members endorsed the OECD-developed standards on transparency and exchange of information: even those countries that up until then had been opposed to exchanging bank information. Thus, the UN incorporated the OECD standard in the UN Model Tax Convention, including the standard of information exchange on request which also applies to both bank and fiduciary information.

In practice hundreds of information exchange treaties have been executed - more than 300 in just 2009 - by jurisdictions that the OECD had classified as not implementing the standard.

Costa Rica's bank secrecy laws and Tax Code obligations for reporting bank information

Bank secrecy is defined as a legal principle that exists in some jurisdictions; according to which, banks are not allowed to provide personal and account information about their clients to authorities unless certain conditions are fulfilled, such as the requirement of a court order.

In Costa Rica, bank secrecy is protected by law so banks must not reveal any data held about their clients that has been obtained as a consequence of transactions conducted with them.

Costa Rica's Commercial Code, Article 615 lays down the protection of bank secrecy by stating: (1) that bank accounts are inviolable and (2) that banks can only provide information about accounts upon request: either with written permission from the owner or by order of a competent court. This does not include the intervention by the Superintendent of Financial Institutions, which is executed according to law.

The protection of bank secrecy is an obligation imposed on every bank, whether public or private, to not reveal any information about either its clients, with whom the banks maintain commercial relations, or their activities - acknowledged by the execution of transactions between them.

However, conflicting with this bank secrecy obligation is that, according to the Tax Code, banks, credit institutions, and financial institutions, whether public or private, must provide information on their clients' financial and economic transactions to the Tax Authority; but, only through the existence of a competent court order issued as a result of the Tax Authority's reasoned petition that there exists an administrative or judicial procedure related with a taxpayer's illegally committed tax action.

The issue of exchange of tax information has become especially relevant since the economic crisis because tax evasion levels in developed nations are very high, and these jurisdictions are desperately trying to emerge from their financial and collection troubles. It is estimated, for example, that approximately 24% of the world's wealth is deposited in tax havens that have very low or nonexistent levels of taxation. This has led developed nations to issue measures to avoid the evasion strategies used by big companies.

Costa Rica's progress on improving compliance

Consequently, there have been discussions between the government and OECD that, to reach international standards, Costa Rica needs to both reform its bank secrecy laws and lift bank secrecy for tax purposes. However, the banking industry had requested that the required court order for lifting bank secrecy not be eliminated. So the Treasurer Minister took this into consideration and eventually an agreement was reached that has now been included in a Bill that not only maintains the lifting of banking secrecy under court order, but also streamlines the process for obtaining information more quickly and easily. This Bill is expected to be submitted to Congress on February 26.

This reform will be published during the International Forum that the Ministry of Finance is organizing in conjunction with the Chamber of Banks and Financial Institutions. In attendance will be Pascal Saint-Amans from the Center of Tax Administration and Policy of the OECD, the entity in charge of the Global Forum on Transparency and Exchange of Tax Information.

Conclusion

Thus, to date, Costa Rica has committed to eliminating bank secrecy - although only strictly for tax purposes: for not only has it prepared its tax reform, but it has also signed an Exchange of Information Treaty with Argentina. Moreover, the country is in the process of negotiating this type of instrument with France, Holland, Canada, and México. Moreover, for this purpose, the government has also initiated contacts with Colombia, Brazil, Uruguay, and Chile.

In the meantime, the government of Costa Rica has informed both OECD and the French authorities about the progress that Costa Rica has made in negotiating Treaties of Exchange of Information; although, these must be ratified by the Legislative Power.

International pressure is very strong, evidenced by the French government pressuring BNP Paribas, the largest bank in France, to announce in September 2009 that it was closing not only its Panama operation, but also its operations in all those countries included in the grey list of the OECD including the Bahamas.

It remains to be seen if these measures are enough to ensure Costa Rica soon being removed from the issued list of countries that OECD and France consider tax havens. ■

For further information please contact:

Carolina Flores, email: cflores@ariaslaw.co.cr; tel: +506 2204 7575

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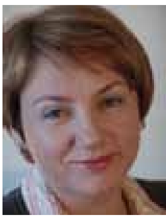
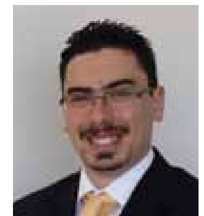


Using Malta Companies as a Tax-Efficient European Base for International Business



Dr Olga Finkel is the Managing Partner and Dr Robert Zammit is an Associate at WH Law Group Malta

Malta offers a winning combination to international businesses looking for an onshore establishment within the European Union that also offers advantages of a low tax jurisdiction. Moreover, Malta structures are also very tax-efficient for holding assets outside of Malta.

While the general rate for corporate taxation in Malta for Malta registered companies is 35%, numerous tax advantages offered by Maltese tax legislation reduce this tax rate in certain circumstances. As such, foreign shareholders of a Malta company may attain an effective tax of 5% on profits on trading activities, and 0% in many cases of holding assets, in particular outside of Malta.

A shareholder of a Malta registered company is entitled to claim substantial tax refunds. Such refunds may be claimed when dividends are distributed out of profits arising from income (except in certain instances, such as income from immovable property situated in Malta). Tax refunds are not subject to further tax (except in the hands of persons who are resident and domiciled in Malta). Moreover, under the Maltese imputation system, the domestic dividends carry a full imputation credit and are therefore, treated as fully taxed when distributed to the shareholder.

One form of the above-mentioned refund is so-called 6/7 tax refund, which is available as long as the income in question is not qualified as passive interest or royalties and the company does not seek double taxation relief on foreign-sourced income.

In Diagram 1, one can see that Non-Resident in Malta shareholder, who receives a dividend from a Malta-Resident Holding Co, which had received dividend from a Malta-Resident Trading Co, would be entitled to a refund of 6/7 of the tax suffered by the trading company on its profits.

One should note that it is the direct shareholders wishing to obtain the tax refund that must register with the Malta tax department and claim the refund. Accordingly, it may be beneficial for the non-resident shareholder to have an intermediary holding company for this purpose. In Diagram 1, such intermediary holding company is shown as a Malta resident holding company, but one can opt also for a non-resident company.

Another form of the tax refund is a so called 5/7 tax refund, which is available in respect of tax on profits arising out of passive interest or royalties where the company does not seek double taxation relief on foreign-sourced income. In this scenario, through the full imputation system and the 5/7 tax refund, a shareholder would be subject to an effective tax rate of 10%.

It is important to note that the Malta resident holding company may qualify in many cases, as shown in Diagram 1, to be a totally transparent structure for tax purposes.

As for holding assets outside of Malta, on satisfaction of certain conditions, shareholders may be able to obtain the full exemption from tax in Malta which exempts from tax completely any dividends received from a holding overseas which is deemed to be a 'participating holding'. A participation held by a Maltese company would constitute a 'participating holding' if at least one of the following conditions is fulfilled:

(a) The Maltese company owns 10% of the equity shares in the non-resident company

(b) The investment in the non-resident company amounts to €1,164,700 or more, subject to a time duration test of 183 days

(c) The Maltese company has the option to acquire the remaining balance of the equity shares in the non-resident company

(d) The Maltese company is entitled to first refusal in the event of the proposed disposal, redemption or cancellation of the remaining balance of the equity shares in the non-resident company

(e) The Maltese company is entitled to sit on the board of the non-resident company

(f) The holding of shares in the non-resident company is for the furtherance of the business of the Maltese company provided further that the shares are not held for trading purposes

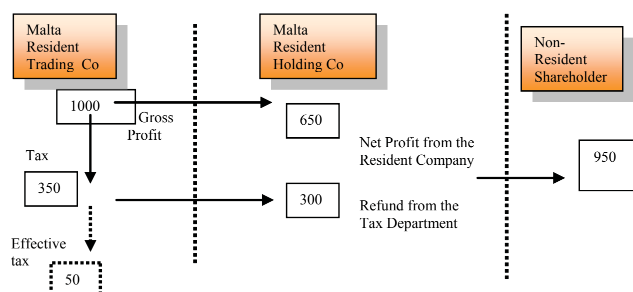
Alternatively, shareholders of a Malta-registered holding company may opt for the full tax refund on distribution of dividends where the said company derives income from 'participating holdings' overseas, resulting in no tax being effectively paid in Malta.

Where the participation exemption relief as described above is not possible, a flat-rate foreign tax credit may be allowed. For this to be applied, the income should be received by a Malta company; provided that the company is specifically empowered to receive income from overseas and in respect of which documentary evidence is available which indicates that such income has been received from overseas. In such cases, a Flat-Rate Foreign Tax Credit (FRFTC) is available. A company claiming FRFTC may claim a tax credit of 25% assumed to have been levied outside of Malta irrespective of whether such foreign tax has actually been levied. FRFTC is calculated on the net income received from abroad before any allowable deductions. Accordingly, the income plus the FRFTC credit are subject to tax at 35%. The shareholder would be then entitled to a 2/3 refund of tax paid by the company.

Malta currently has close to 50 double taxation relief treaties in force, most of which are based on the OECD Model Convention. In most of its double tax treaties Malta has agreed to relieve double taxation using the tax credit method.

As was shown above, there are various methods of obtaining very competitive effective tax rates for Malta-registered companies, both for trading activities, as well as for assets holding and exploitation, both tangible and intangible. This coupled with the fact that Malta is a full member state of the European Union, has an extensive network of double taxation treaties, and also provides incentives for a variety of industries (please refer to our article on incentives in Vol. 3 Issue 3, September 09 issue of *World Commerce Review*) makes Malta a very attractive base for multinational operations. ■

Diagram 1



For further information please contact:

Olga Finkel olga.finkel@whlaw.eu
Robert Zammit robert.zammit@whlaw.eu
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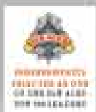

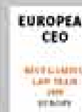

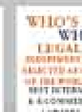

SUITE A, DOLPHIN COURT A
EMBASSY WAY
TA' XBIEX XBX 1071
MALTA

TEL: (+356) 21332657
(+356) 21332653
FAX: (+356) 21332490
CELL: (+356) 79657512

EMAIL: INFO@WHLAW.EU
OLGA.FINKEL@WHLAW.EU
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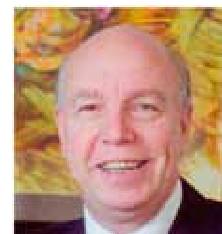
The Use of Dutch Legal Entities in International Tax Reduction Strategies, Part II



Jos Peters is the Senior Tax Partner at Merlyn International Tax Solutions Group

Dutch legal entities can surprisingly easily be "hybridised" for international tax reduction purposes. In a previous article *(WCR December 2009)* we have depicted how this might work with a Dutch "Cooperative Association". This month's contribution deals with hybridisation of the standard Dutch limited liability company: BV.

Introduction

- Hybrid entities are legal entities which in the country of the parent of the multinational group are seen as legal entities, so they are considered to be subject to tax of their own accord, whilst the foreign investment jurisdiction considers them as "partnerships". Such entities are not subject to tax themselves but their owners/shareholders may be, if they are deemed to run a permanent establishment in the investment country. Or the other way around ("reverse hybrids"). Many legal entities can be hybridised or are even hybrid by nature, due to the differences in the classification rules for foreign entities between the tax laws of countries;

- This may well lead to double taxation (one country taxes the entity, the other country taxes the partners on the same income). However, the opposite is also possible: the entity is not taxed by either tax authority of the countries it does business in; this is especially true for Europe where many countries exempt foreign dividends from local tax;

- Countries do not normally take foreign legal or tax aspects into account when establishing their tax classification rules for foreign entities: they invariably use their own criteria. These criteria differ manifestly per country, however. There are no signs that countries are planning to, or are even willing to, align their entity tax classification rules with one another, any time soon.

- In many cases one can make deliberate use of "automatic" hybrids: no tax authority, neither at home nor abroad, will consider them odd or artificial, because they are widely used by others in a non-hybrid way.

The automatic hybridisation of a standard Dutch BV

The Netherlands, like many other tax jurisdictions, recognizes the notion of tax consolidation, widely known amongst tax practitioners in the Netherlands as "fiscal unity". Any Dutch parent company which was incorporated in the format of an NV a BV, an SE or a Cooperative Association ("Coop") can form a tax consolidated group with one or more of its subsidiary NV's, BV's or SE's (Coops can only act as parents in such a group, not as subsidiaries). NV's and SE's are not different from BV entities as regards hybridisation and will therefore not be discussed separately in this article. What I describe for a BV will also work for an NV or an SE in my country.

When taking a closer look at this feature, a few key points come to light which make the Dutch tax consolidation rules differ markedly from those of other countries.

Dutch "fiscal unity" is optional and a request must be filed on a subsidiary by subsidiary basis to achieve such a position. A Dutch parent can elect to form a fiscal unit with any combination of its BV, NV and SE subsidiaries which it deems appropriate. If it is better to leave one or more subsidiaries out of the fiscal unit, one is fully free to do so: "junction" is always possible at a later moment. Tax payers are also free to choose the moment when the fiscal unity starts and stops: this can be any workday throughout the year, also on a subsidiary by subsidiary basis.

A crucial element of a subsidiary entering a Dutch fiscal unit is, that from that moment onwards, the subsidiary becomes invisible for Dutch corporate income (CIT) tax purposes. The subsidiary, for CIT, <u>ceases to exist</u>. Its assets and liabilities are deemed to have been absorbed by its parent and the entity, from the junction moment onwards, is treated as a Dutch branch office of the parent. As a consequence, the subsidiary can no longer file a Dutch CIT return of its own.

Many tax practitioners worldwide are familiar with this Dutch "fiscal unity" procedure and it is often applied almost automatically: if a Dutch entity incorporates or acquires a Dutch subsidiary of which it owns 95% or more, a request for fiscal unity is filed with the tax authorities, often without further input from tax counsel: "the bookkeeper can do it" (and he/she usually does so).

This automatic pilot approach is by no means obvious, however. Fiscal unity in the Netherlands is subject to strict anti-abuse rules, both for a subsidiary entering a fiscal unit and for a subsidiary leaving the tax group, to avoid that tax claims get lost in the process. Such provisions could well kick in, also in cases of non-abuse, because of the way they were written. Or they may lead to unwanted side-effects. This should really be looked at in some depth before a fiscal unit is requested or enlarged and I have seen many cases whereby avoiding fiscal unity gave much better tax results long term than filing for it. After all, saving yourself the expenses of filing an extra CIT return should not be the driving factor, but this is often not well understood.

In this article I will not go into these side-effects of the fiscal unity concept, however. I just want to address an – equally often overlooked – main effect: if a Dutch company, which is a subsidiary of another Dutch company, files for fiscal unity, it ceases to exist only for Dutch CIT purposes and <u>ONLY in the Netherlands</u>. If such a company has business abroad, it will continue to be subject to foreign corporate income tax abroad in its own name and for its own account, regardless of the fact that it no longer exists for Dutch CIT purposes! After all, the company continues to exist for Dutch legal purposes and for all Dutch taxes except CIT.

Filing for Dutch fiscal unity treatment, for Dutch BV entities which operate foreign permanent establishments or possess foreign assets which give rise to foreign tax liabilities (eg. foreign real estate), therefore implies an automatic hybridisation of such entities: they cease to exist for CIT purposes in the Netherlands but continue their lives for CIT purposes abroad.

The stunning overall tax effects of an automatic hybridisation of a Dutch BV

It is easy to overlook the <u>ultimate</u> consequence of the notion, in Dutch corporate income tax law, that upon tax consolidation, the Dutch subsidiary company of a Dutch parent company "ceases to exist", because it is not primarily a tax effect which arises, but a legal effect. But this legal effect may have huge tax consequences.

If a company which forms part of a Dutch tax consolidated group "ceases to exist", as article 15 of the Dutch corporate income tax act describes it, this may have very significant consequences for any agreements which this entity may have entered into with the other companies in the Dutch tax consolidated group, including its parent

company:

1) Intra-tax-group contracts will have to be ignored for Dutch CIT purposes as well. One cannot borrow money from oneself, one cannot enter into a licensing agreement with oneself, one cannot put employees to the disposition of oneself, one cannot rent equipment from oneself, etc. etc.

2) Any income resulting from these intra-tax-group contracts therefore becomes invisible for corporate income tax purposes in the Netherlands. And invisible income cannot be taxed...

So the bottom line, for the Netherlands taxation of such a hybrid standard Dutch BV entity, is:

An entity which disappears for Dutch CIT purposes upon filing a Dutch fiscal unity request, will see all of its intra-tax-group contracts disappear in the Netherlands, which in its turn leads to disappearing income in the Netherlands from such contracts, which might otherwise, if earned outside a fiscal unity context, have formed regular taxable income in the Netherlands.

As observed, the Dutch entity – if it has foreign operations - does not disappear abroad. There the entity continues to be a foreign tax payer with the obligation to file an annual CIT return. Its agreements with other Dutch entities in the Dutch tax consolidated group do not become invisible abroad and the income from such agreements does not disappear from the foreign tax radar either.

Income for one group company, under an intra-group agreement of whatever form, means expenses for the other group company. Hybridising a Dutch BV with foreign operations may therefore cause very significant tax reductions for the multinational involved, since one country must allow tax deductions for expenses incurred whilst the country where these expenses form income, does not recognize this income for CIT purposes.

An example in the area of "intra-group leasing of trucks"

Say a US fruit transportation company "Frutrans Inc." seeks to invest in similar activities in Europe, for instance the transportation of fruit from South-Spanish harbours (where it comes in from fruit producers in Northern-Africa) to France, Holland, Germany, Sweden and other areas north of Spain. Frutrans Inc. sets up a Dutch (Parent) Company X BV which sets up a 100% Dutch Subsidiary Company Y BV, and both BV's form a Dutch tax consolidated group by filing a standard request form. The Dutch tax authorities will normally always accept such a request as the law contains no grounds for a refusal.

X BV subsequently purchases a number of specialized trucks and trailers, suitable for fruit transportation. This is done from a capital infusion which it will obtain from its US parent Frutrans Inc. Let's say BV X invests €100 million. The trucks and trailers are subsequently leased out to Y BV which sets up a substantial branch office in Spain (virtually all business activities of BV Y will take place in Spain where the customers are which seek transportation of their fruit to Northern-Europe). The lease contracts between BV X and (the Spanish branch of) BV Y are drafted in such fashion that they meet the "arm's length" standard for transfer pricing: BV X charges BV Y no more than a third party would charge BV Y for similar lease contracts under similar circumstances.

Let's assume that a transfer pricing study shows that the arm's length lease fee which Y BV has to pay to X BV for these trucks and trailers amounts to €17.5 million per annum. The Spanish branch office of X BV will be able to deduct these rental fees from its taxable profits in Spain, both under regular Spanish corporate income tax law and if needed under article 7-3 of the Dutch/Spanish tax treaty, which would override any Spanish limitations. The Spanish CIT reduction attributable to the lease contracts is around €5.5 million per annum.

But because Y BV does not exist in the Netherlands, its rental agreement with X BV also does not exist for Dutch corporate income tax purposes, so the Dutch tax consolidated group "X BV" (Y BV has disappeared) cannot recognize the rental income which Y BV paid to X BV for Dutch corporate income tax purposes and this income remains untaxed in the Netherlands. The net/net tax benefit of this setup is then equal to the Spanish tax savings from being able to deduct lease fees rather than depreciation of, some €10 million per annum, which equals €2.5 million each year; if the lease continues after the 10 year depreciation period, the tax benefit increases to 35% of €17.5 million or almost €6 million per year.

Intercompany contracts might of course cover all kinds of relationships, not just the rental of vehicles. Also in these other areas, the Dutch income disappears and the multinational group will be able to save itself millions of tax in the countries of their operations. You might think of:

a) A production environment, where foreign branches of Y BV produce goods under a licensing agreement for the US patents in use (X BV obtains the exploitation rights for these US intangibles, for use outside the USA, from its parent company in the form of a contribution to capital and licenses them to (the foreign branch of) Y BV;

b) A sales environment: X BV enters into a commissionaire agreement with sales and service subsidiary Y BV, which operates via permanent establishments (branch offices) abroad. The commissionaire agreement substantially reduces Y BV's taxable income abroad but the income which flows to X BV as a result of this remains untaxed in the Netherlands because the commissionaire agreement does not exist from a Dutch viewpoint, so X BV files for a much higher amount of foreign profits (exempt from CIT in the Netherlands) than actually reported abroad.

A case like this has been litigated in the Netherlands with astonishing results

The Dutch Supreme Tax Court decided in a long and well documented decision which it handed in 2003, after more than 12 years of litigation concerning a case of "disappearing income" as described above, that the phenomenon of disappearing entities in Dutch tax consolidated groups does indeed lead to disappearing income from intra-tax-consolidated-group transactions and that the tax payer concerned was right in not reporting taxable income from such transactions as profit for Dutch corporate income tax purposes. The Supreme Court saw no reason whatsoever, despite repeated pleas by the Dutch Ministry of Finance during the appeals process, to take any tax effects in the country of the foreign operations of the Dutch subsidiary company into account. The verdict was firm and unambiguous.

The Supreme Tax Court also made it clear that this was not a decision in the case at hand only (factual decision), but an affirmation of a cornerstone of the Dutch CIT system, also in other cases where income might disappear as a result of the fiscal unity rules. The court even emphasized that the tax planning behind these structures can in no way be regarded as "abusive" under any Dutch "abuse of law" rule.

Will the law now change in the Netherlands to prevent this outcome?

Tax legislators have the opportunity, if court cases get lost by the revenue service, to adapt the law if they can convince Parliament that the outcome is unwanted. This was also the base attitude in the Dutch Ministry of Finance when the case was first litigated in the late eighties of the previous century. In fact, an anti-abuse article was introduced in the Dutch CIT Act in 2002 to make sure that the Dutch foreign income exemption for a tax payer of running foreign operations in its own name (via branches or the possession of foreign real estate) would not be higher than the income declared abroad.

But after the Dutch Supreme Court decided in 2003 that the tax payer was not only right, under the old law, to not report certain income under the Dutch fiscal unit rules, but that this approach also did not constitute any form of abuse under Dutch tax law and tax principles, the Ministry of Finance unexpectedly decided to remove the anti-abuse rule. It did so per 01/01/2005 when several fiscal unity rules were up for revision and clarification.

Per today there is only one anti-abuse element still in force: if a group entity in a Dutch fiscal unit grants a loan to another tax group

member, which loan is used in a foreign permanent establishment of the subsidiary entity or for the financing of foreign real estate owned by that subsidiary entity, the interest on that loan will be added to taxable income in the Netherlands even if it does not exist under fiscal unity principles, unless the tax payer proves that the interest has not been tax deductible abroad. All other types of intercompany agreements between members of a Dutch fiscal unit have been taken out of the anti-abuse rule and tax payers are free to use the Dutch fiscal unity rule, which allow for disappearing income, to their financial advantage.

Multinationals without Dutch business can also benefit from the Supreme Court verdict

Setting up a Dutch intermediate holding company, which incorporates a Dutch subsidiary which operates foreign branches, can not only be financially beneficial for Dutch multinationals. These tax planning structures are equally open to multinationals from other countries. Nothing should stop a Swedish multinational with plans to start production in Singapore to put the above described Dutch "sandwich" in between: Singaporean CIT will substantially be reduced, the Netherlands will levy no tax and Dutch dividends will be tax exempt in Sweden. In fact, almost any multinational in a country which exempts foreign dividend income from taxation can benefit.

Even multinationals in "tax credit" countries such as the USA, Australia, the UK, Canada, China and Japan may benefit substantially from this "Holland routing" of part of their corporate income. This might be the case if they are looking for low-taxed foreign source income to avoid excess credit situations at home, or it might, in the absence of CFC type tax legislation at home, lead to at least very substantial tax deferrals for the group, with a corresponding rise in earnings per share! ■

For further information please contact:
Joseph Peters MBA, tel: +31 10 201 0820 Mob: +31 654 702084
Email: jos@merlyn.eu

World Commerce Review International Tax Specialist Award 2010

World Commerce Review is pleased to announce the prestigious inaugural **International Tax Specialist Award 2010** has been awarded to Merlyn International Tax Solutions.

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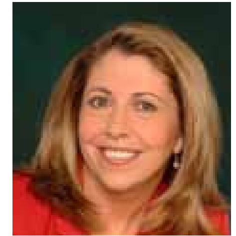


Karen Lobdell is Director of Trade Security and Supply Chain Services at Drinker Biddle & Reath LLP, Chicago, IL and a member of the current Advisory Committee on Commercial Operations of US Customs and Border Protection (COAC).

With 2009 now a spot in the rear view mirror, global businesses have entered the new year hoping that the worst is behind them and setting their sights on moving things in a more positive direction in 2010.

Over the past year, companies have been forced to review their business models from every aspect and look for ways to improve cost structures and increase efficiencies. Global supply chains offer many opportunities for reducing cost, whether through obtaining price reductions from service providers, considering low-cost country outsourcing, or trimming personnel that manage supply chain components such as logistics and/or compliance – everything is fair game. Even as economic conditions improve, companies will continue to maintain the low-cost structures they have put in place over the last 12 months. Of course, reducing cost must be done in a manner that will not result in increased risk; a challenge to be sure.

One area of supply chain management to keep an eye on in 2010 is trade compliance. Companies operating in the global arena are faced with a myriad of rules and regulations to which they must adhere. A company can have the fastest carriers, lowest transport pricing and most strategic distribution network. If, however, it fails to comply with international trade regulations, its supply chain can come to a complete stop, resulting in significant cost. And failure to comply can result in substantial monetary penalties, seizure of product and publicity damaging to the brand.

A review of just a few of the regulatory challenges facing international traders in 2010 is worthwhile – before trimming from the trade compliance function. Failure to provide the necessary resources to ensure compliance in these areas will have a negative impact on a company's bottom line.

Trade security

Trade security will continue to be a top priority for customs administrations around the world in 2010. Incidents such as the failed Christmas Day bomb attack targeting a Detroit-bound aircraft only reinforce the need for continued efforts in this area. As a result, companies operating in the global arena will need to ensure resources are dedicated to compliance with security rules.

The Importer Security Filing (ISF)

The United States began enforcement of the Importer Security Filing (ISF) rule, also known as "10+2," on January 26, 2010. The rule requires US importers as well as carriers (for vessel cargo only) to provide additional data elements 24 hours prior to cargo being laden on board at foreign origin to conduct more thorough risk assessments of US bound cargo. Similar actions are pending, or have already been put in place by customs administrations in China, Canada and the European Union.

Although the ISF regulation was implemented on January 26, 2009, in light of the far-reaching impact this rule had on the trade, US Customs provided a 12-month period of delayed enforcement to allow the trade time to implement necessary controls. Full enforcement is now underway, however, and for those companies that have not taken the past year to ensure compliance, the risk can be substantial. Non-compliance may result in: (1) liquidated damages of $5,000 per violation (up to $10,000 per filing); (2) "Do Not Load" directives at origin requiring the cargo to be left off the vessel; (3) denial of permission to unlade cargo at US port of arrival; (4) inspection/examination of cargo prior to release; and (5) seizure of cargo.

Despite the US importer being the legally responsible party for the ISF, companies outside the US supplying US importers should also take note. Of the 10 data elements that the US importer must provide, there are a few that will require the importer to rely on input from foreign suppliers (eg, manufacturer name/address, container stuffing location, consolidator name/address, bill of lading number). Proactive communication between parties in the supply chain to provide this information is critical. Failure to collaborate with the importer to capture and transmit this data timely could result in the importer issuing charge-backs or simply sourcing goods elsewhere.

100 percent air cargo screening mandate

On August 3, 2007, the Implementing Recommendations of the 9/11 Commission Act of 2007 became law in the US, requiring that, by 18 months after the enactment of the bill (February 1, 2009), 50 percent of all cargo on passenger aircraft be screened and by August 1, 2010, 100 percent be screened. The level of security with respect to screening must be commensurate with that of checked baggage – at the piece level. *The bottom line is that only cargo that is 100 percent screened at the piece level will be uplifted on passenger planes as of August 1, 2010.* This will affect not only US domestic cargo, but also all US exports moving via air.

The US Transportation Security Administration (TSA) was able to meet the mandate for 50 percent screening on February 1, 2009, with the Narrow-Body Screening Amendment, which became effective on October 1, 2008. Under this amendment, all cargo uplifted in the US on narrow body aircraft (export or domestic flights) must be 100 percent screened at the piece level before it is netted, containerized, etc. and shrink-wrapped skids must be disassembled and all pieces screened individually. Meeting the mandate for the remaining 50 percent by August 1, 2010, however, is going to be a major challenge. The airlines are already approaching their maximum screening capabilities, there is no funding provided for the screening, there is limited screening technology and screening at the piece level poses many problems.

The legislation requires the TSA to establish a program to assist with the mandate. To aid the trade and TSA with meeting the mandate, TSA created the Certified Cargo Screening Program (CCSP). CCSP is a voluntary solution, in which various entities in the supply chain can participate, including shipping facilities, manufacturing facilities, 3PLs, contract manufacturers, warehouse/DC centres, freight forwarding facilities and independent cargo screening facilities (ICSF). By meeting specific TSA security requirements – similar in concept to the US Customs-Trade Partnership Against Terrorism (C-TPAT), or the WCO Authorized Economic Operator (AEO) – CCSP-certified parties can pre-screen their own cargo using TSA approved methods, ensuring no delays at the airport, and avoiding further handling of their cargo by other parties that could result in contamination, damage and/or breaking down of pallets.

With only a few months before the August 2010 deadline, however, participation in CCSP has been very limited and many companies have yet to implement procedures to address this regulation. Companies purchasing from US suppliers would be well advised to initiate discussions as to how this mandate will be met. Failure to do so may result in: (1) cargo being diverted to other slower modes of transport (eg, ocean or truck); (2) cargo undergoing intensive screening that could result in damage to the product or; (3) cargo missing scheduled flights.

Although the TSA options in the US can assist in meeting the mandate for US domestic and export cargo, the same cannot be said of international air cargo bound for the US. Harmonization of US air cargo security standards with those of other nations will be a bigger challenge and will take time. In September 2008, the European Union and the US entered into an agreement to coordinate efforts to enhance air cargo security. These efforts are still underway and are just one example of what may be seen in other markets.

Product safety

Over the past few years, there has been an increasing number of incidents involving product safety in the global marketplace. A short list of issues includes dangerous levels of lead found in paint and children's products, melamine in milk products, antifreeze in toothpaste, heparin blood-thinner contamination and various incidents of food product contamination. These incidents were not isolated to any one region and have had a global impact on supply chains as customs administrations, along with other government agencies, look for ways to target these risks earlier in the supply chain.

The Consumer Product Safety Improvement Act (CPSIA)

The CPSIA, signed into US law in August 2008, was designed to establish consumer product safety standards and other safety requirements, with a heavy focus on children's products. The law also expands the role of the Consumer Product Safety Commission (CPSC) in ensuring the safety of consumer products and sets higher federal standards. The CPSC has jurisdiction over approximately 15,000 types of consumer products used in homes, schools and recreation.

"A company can have the fastest carriers, lowest transport pricing and most strategic distribution network. If, however, it fails to comply with international trade regulations, its supply chain can come to a complete stop, resulting in significant cost"

Among the most challenging provisions of the CPSIA were those dealing with lead limits, testing and certificates of conformity – most notably those pertaining to children's products. Additionally the Act includes provisions for phthalates prohibition, product registration, tracking labels, mandatory recall notices and increased penalties for violations. Deadlines for compliance have varied due to stays of enforcement and delays in establishing accredited third party testing facilities (which are mandatory for children's products). The most current posting of updated requirements can be found at http://www.cpsc.gov/cpscpub/prerel/prhtml10/10083.html.

Non-compliance carries a heavy cost, as the CPSIA increases the potential civil penalty caps for violations from $5,000 to $100,000 per individual violation, and from $1.25 million to $15 million for aggregate violations. Criminal penalties could also be imposed for non-compliance, including imprisonment and forfeiture of assets. At a minimum, supply chain delays will occur.

US importers must ensure products meet applicable standards (eg, lead content), conduct necessary product testing (third party testing for children's products) and have a certificate of conformity for products subject to any standard or ban covered under the Act. For those companies supplying US importers, the safety of the product will be more closely scrutinized and failure to meet safety mandates will result in loss of business, as production shortcuts and use of prohibited materials such as lead and phthalates will no longer be allowed.

Renewed interest on exports

Export controls

Entering 2010, compliance with US export regulations continues to receive increased attention. While security of US imports took centre stage in the years immediately following 9/11, the government has taken a steadily increasing interest in export controls, with increases in both the penalties applicable per violation and in enforcement activity.

The US Government has substantially increased action against organizations and individuals responsible for breaches of the export regulations in recent years. These regulations include Export Administration Regulation (EAR), International Traffic in Arms Regulations (ITAR), as well as the US Office of Foreign Assets Control (OFAC). Perhaps one of the more notable enforcement actions since this increased emphasis was in 2007 when ITT Corp. was fined $100 million in fines and forfeitures for illegally transferring classified and export controlled night vision technology to foreign countries.

More recently, a British subsidiary's plea to two counts of illegally exporting commercial Boeing 747 aircraft from the United States to Iran is the latest reminder that violations of US export laws are being aggressively pursued and prosecuted. The resolution of this matter involved both a $2 million criminal fine and a $15 million civil penalty, one of the largest penalties for export violations in the US Department of Commerce's Bureau of Industry and Security's (BIS) history. http://www.treas.gov/offices/enforcement/ofac/civpen/penalties/balli_02052010.pdf.

Balli Aviation Ltd, (Balli) pleaded guilty on February 5, 2010, to illegally exporting three commercial Boeing 747 aircraft from the United States to Iran. Balli conspired to export the aircraft without the required export license from BIS, in violation of the EAR, and without obtaining authorization from OFAC, in violation of the US sanction regulations on Iran.

Violators may also be subject to denial of their export privileges, which prohibits a person from participating in any way in any transaction subject to the EAR. Other businesses and individuals are also prohibited from participating in any way in an export transaction subject to the EAR with a denied person. BIS recently issued a $2.5 million penalty against Sirchie Acquisition Company LLC, a North Carolina company, for violating the terms of a denial order when an officer of the company (who was personally subject to the denial order) did as little as set pricing for goods to be exported. Actions such as these will directly impact the ability of a company to remain competitive in today's global marketplace.

US Foreign Corrupt Practices Act (FCPA)

Under the FCPA, anti-bribery provisions prohibit directly or indirectly offering anything of value to any foreign official for the purpose of influencing the decision of that official to do anything that assists the offer or in the obtaining or retaining of business. Provisions on recordkeeping require public companies to make and keep books, records and accounts that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer. There is no materiality threshold. Companies must also maintain a system of internal compliance controls that provides reasonable assurances that transactions are executed in accordance with GAAP.

Like many of the export control regulations noted above, the FCPA has been around for decades, but was rarely enforced until recent years.

In 2008, a major German company was fined $800 million for violations of the FCPA, in addition to significant penalties under a comparable German law. This enforcement action and others have resulted in more - and higher - penalties being issued under the FCPA in the last three years than in the previous 20 in which the law existed.

The penalties that can be imposed for FCPA violations are severe, and can include:

(i) *For companies* – felony convictions, fines of up to $2 million per violation, disgorgement of a company's profits on contracts secured with improper payments, denial of export licenses, and debarment from doing business with the US government. Companies will often be required to submit to an independent compliance monitor for multi-year periods, a process which can be cumbersome and expensive.

(ii) *For individuals and executives* – felony convictions, imprisonment up to five years and fines up to $100,000 per violation, along with disgorgement and debarment.

Companies and individuals also face substantial defence costs and the loss of reputation associated with being criminally charged under an anti-bribery statute.

As companies continue to look for ways to reduce costs in 2010, it will be important to keep the above concerns in mind. Mitigating risk with respect to trade compliance does have a cost, but the cost of non-compliance can certainly be much greater. ■

CYPRUS - The Best Location for Maritime Services and Investment

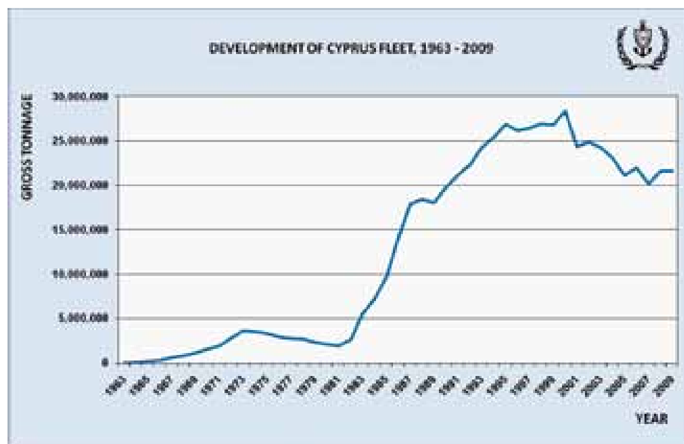
The Cyprus Department of Merchant Shipping, in a wide-ranging interview with World Commerce Review's Tom Page, examine the state of the shipping industry, the most important method of freight transportation worldwide

Please describe the history of the DMS

The Department of Merchant Shipping (DMS) was established and started functioning as a distinct entity in the Ministry of Communications and Works, in 1977. The service existed, however since 1963 and functioned under the Department of Ports. The headquarters were situated in Famagusta, which was also the port of registration of Cyprus ships but was transferred to Lemesos (Limassol) after the Turkish invasion in 1974.

Since its establishment, the DMS has been strengthened with professional, administrative and clerical personnel enabling it to implement its policy and accomplish its objectives. In addition to its headquarters in Lemesos, the DMS has established six overseas offices in order to improve its efficiency and the exercise of effective control regarding the implementation of the provisions of the shipping legislation. These offices are situated in Piraeus, London, Rotterdam, New York, Hamburg and Brussels.

The establishment of the DMS inaugurated a new era of development of Cyprus in this important sector. The registration of ships became just a part of an all round effort to establish a sound infrastructure which would facilitate not just the registration of ships but also ship management and other shipping related activities in Cyprus. The Cyprus Registry has shown phenomenal growth in the last twenty eight years. In the early eighties Cyprus ranked thirty-second on the list of leading maritime nations. **It now ranks among the top ten with a merchant fleet exceeding 21.5 million gross tons.** Also, the Cypriot merchant fleet ranks third in the European Union with a percentage of about 12% of the total fleet of the 27 EU member states.



What is the role and mission of the DMS?

The DMS is responsible for the development of maritime activities which include: registration of ships, administration and enforcement of the Merchant Shipping Laws, control of shipping and enforcement of international conventions ratified by the Republic of Cyprus, investigation of accidents involving Cyprus ships or seamen serving on those ships or foreign ships sailing within the territorial waters of the Republic, resolving labour disputes on board Cyprus ships and training and certification of seafarers.

The basic aim of the DMS is the sustainable and continuous growth of the Cyprus shipping industry and the improvement of its competitive position through the continuous development of the maritime infrastructure, the improvement of the quality of the merchant fleet, the enhancement of the international reputation of the Cyprus flag and the wide international recognition of Cyprus as an established maritime centre.

How has Cyprus evolved as a global ship management hub?

Unlike other open registries, Cyprus is also a major base for international shipping operations and for other shipping related activities. Cyprus is considered today as one of the leading third-party ship management centres in the world. More than 60 ship management companies are established and operate in Cyprus, some of which are considered among the largest ship management companies in the world. It is estimated that they manage about 20% of the world's third party management fleet. Around them, more than 100 companies have been established with shipping related activities ranging from marine insurance, ship chartering, ship broking, financial services, equipment suppliers and telecommunications, to port services, transhipment operations, ship bunkering, shipping agency and ship chandlers.

Cyprus is a country whose economy is dependent to a large extent on services. Its strategic location at the crossroads of three continents (Europe, Asia, Africa) enabled it to play a prominent role as an international trade and shipping centre. Consequently, shipping is one of the areas which have shown substantial growth in the last decades and it presents remarkable potential for further development.

In its effort to fulfil its mission of being established as one of the world's most significant shipping centres, the DMS adopted a number of fiscal and economic incentives which prompted the establishment by many European and other foreign entrepreneurs of local companies with fully fledged offices in the island. Such incentives include competitive ship registration costs and annual tonnage taxes and a favourable tax regime for ship management and other international business enterprises. To be more specific regarding the ship management companies, those operating in Cyprus have the option either to pay tonnage tax, at a fraction of the normal rate, on the basis of the tonnage of the ships they manage, or to pay tax on their income at a rate of 4.25 percent.

Furthermore, the availability of competent local employees and generally the low operating and office costs have also contributed to the success of establishing a well known shipping centre in Cyprus.

The DMS continuously improves and modernizes the incentives offered to shipping entrepreneurs ensuring that its attractiveness and competitiveness as a ship management hub and shipping centre in general are safeguarded.

What is the policy with regard to high risk vessels?

The DMS in its effort to enhance the safety and quality standards of Cyprus flag ships has introduced a number of measures over the last few years.

The measures adopted primarily aimed to improve the safety performance of Cyprus flag ships, companies managing Cyprus flag ships as well as recognized organizations. These included carrying out flag State inspections and audits and following up their safety record. A network of independent inspectors was established to provide adequate coverage of inspections globally.

Furthermore the DMS has refined its policy regarding the registration

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of ships in order to strengthen the screening processes of ships to be registered under the Cyprus flag. Under this refined policy the safety record of all ships applying for registration is thoroughly examined and in some cases additional surveys are carried out by the surveyors of the Department prior to the permanent registration of the ship. Also, age limits have been imposed for the registration of certain categories of ships.

The effective implementation of these measures enabled Cyprus to achieve a 'White List' status in the flag assessment system maintained by the Paris and the Tokyo MoUs on port state control and to be removed from the "List of Targeted Flag States" of the US Coast Guard.

Please describe the Cyprus advantage

Cyprus is situated in the eastern Mediterranean, lying at the hub of three continents and close to the busy trade routes linking Western Europe with the Arab World, Africa and the Far East. Cyprus has an open free market economy characterised by robustness and macroeconomic stability, which is evidenced by the favourable evaluations and comments of the European Commission, the International Monetary Fund and other international organisations.

The participation of Cyprus to the European Union and especially to the Economic and Monetary Union and the adoption of Euro as its official currency, safeguards economic and exchange rate stability and creates new opportunities for business in the Middle East and Europe.

Cyprus combines an efficient civil service, low set up and operating costs for companies, availability of highly qualified labour force in the technical, scientific and clerical categories, good labour relations, an outstandingly high level of professionalism in the legal and accounting sectors, an excellent banking system, advanced telecommunications, air links to all important destinations and the lowest EU corporate tax rate (10%), that form solid foundations for entrepreneurs to set up a regional business or a branch in Europe. Cyprus has every potential to become your entrance to the European market.

In addition, there is a highly favourable taxation regime in the shipping sector whereby ship-owning and ship management companies are taxed on the basis of a tonnage tax instead of income tax. Thus, without being a tax haven, Cyprus offers an ideal environment for living and doing business.

How has EU accession affected the market?

With Cyprus joining the European Union a number of "sacrifices" needed to be made against its shipping sector. There is a loss of flexibility in policy making and in effecting changes in the taxation regime. However, this is counterbalanced by the active participation of the DMS in the decision making process in the EU and the influence that we have been able to build.

Our aim is to use our European orientation not as a stumbling block but as an additional advantage, by exploiting whatever incentives the EU has made available to shipping and safeguarding, to the extent possible, the interests of Cyprus shipping. Indeed, the harmonisation with the EU acquis expedited the modernisation of the Cyprus maritime legislation in the fields of maritime safety and security, whereas, at the same time, Cyprus maintained and even improved in some aspects its competitiveness as a global shipping centre.

How is ship management changing in an on-line world?

Nowadays, information and communications technology is the number one tool that links the whole world. Modern IT and Communication systems evolve very fast and become more user-friendly, thus offering everyone instant access to the available information. This is crucially important for shipping. Good and safe communication between ships and offices are key factors for the success of a shipping company and for shipping in general.

Ships are operating in a worldwide environment and therefore fast information exchange needs to be ensured. This enables precise and effective decision making which is a key factor in the success of a ship management company. Modern information and communication systems also support the shipping companies during this world economic crisis and assist them to remain as competitive as possible, exactly by offering the means for timely and proper decision making at a low cost.

Another important change that fast telecommunications and IT technology have effected is the specialization of ship management companies. Thus, technical, crew and commercial management, each one governed by extensive international and national legislation are now offered separately, at a high quality/state of the art level, instead of being offered as a package.

How do you view future developments in the sector?

The shipping crisis, besides its immense impact on the shipping markets, it also creates opportunities for specialised services in the shipping industry, since ship owners and operators focus their efforts on finding ways to improve efficiency and to reduce costs. Third-party ship management often proves for ship owners to be more cost effective than in-house management. Cyprus has every potential to attract a significant proportion of the expected increase in the world-wide rendering of ship management services. In this respect, the current shipping crisis creates a new area of opportunities for the Cyprus ship management industry to expand its business.

Furthermore, a new taxation framework, based on tonnage tax, has been submitted for approval by the European Commission. It is anticipated that the new law will be enacted as soon as it is approved by the EC, hopefully during the first half of 2010. Under the new taxation framework, Cyprus competitiveness will be improved and it is anticipated that its shipping industry and especially its ship management cluster will grow further.

What innovative projects are being developed by the DMS?

The DMS has launched an electronic application system for the issuance of Seafarer's Identification and Sea Service Record Book (SISRB), the issuance of endorsements attesting the recognition of non Cyprus certificates, the issuance of Cyprus certificates of competency and Cyprus training certificates. Furthermore, the DMS is in the

process of developing new e-services aiming at the provision of on-line access to a large range of information and services. Presently, the Department offers online Authentication of Seafarers´ Certificates and on-line customer payments.

The DMS has installed a Vessel Traffic Monitoring and Information System (VTMIS) which aims to enhance the safety and efficiency of maritime traffic, port and maritime security, to improve the response of the national authorities to incidents, accidents or potentially dangerous situations at sea, including search and rescue operations, thus contributing to a better prevention and detection of pollution by ships.

The VTMIS has been in operation on a pilot basis since May 2008 and will be fully operated shortly. Furthermore, the Department has implemented the "SafeSeaNet" system which facilitates the exchange of maritime information between the EU member states enhancing maritime safety and prevention of marine pollution.

Since November 2009, the DMS has fully implemented a long-range identification and tracking of ships (LRIT) system which underlines the determination of the international maritime community and Cyprus to protect the shipping industry against unlawful acts and at the same time improve the safety of navigation and the protection of the marine environment.

How has the global decline affected the maritime sector?
Historically, the markets have been periodically good and bad and the shipping industry has learned to survive. For the experienced entrepreneurs, the current fall was inevitable, as a result of the expected increase in the supply of ship's tonnage, with newbuildings entering the market in large numbers. However, the intensity of the shipping crisis is beyond any traditional cyclicality and appears to have surprised even the most experienced.

In view of the financial crisis which led to a global economic downturn, the demand for transport of goods and raw materials has dropped, as an immediate reflection of the slump of the consumer spending in Europe and North America. Consequently, the freight rates fell below or close to breakeven levels for most classes of ships. The crisis led to considerable order cancellations and scrapping of ageing vessels. A significant part of the world fleet is laid up waiting for cargo. The shipping industry witnessed both bankruptcies and more consolidation, driven as much by massive over-supply as weak demand. Some companies have already dropped out of the market, experiencing a "market cleansing" phenomenon. Some others may follow soon.

As far as Cyprus is concerned, during the last eighteen months the Cyprus register recorded a slight decrease. We believe that the recession had a slow down effect on the growth of the Cyprus fleet due to a large number of new-building cancellations. Without the downturn, the Cyprus registry would have expanded, especially in view of the improvement of the quality standards of the fleet and the establishment of a new image of its flag.

In conclusion, how bright is the future for the maritime industry?
Phases of substantial boom followed by sharp declines are typical for the shipping industry. The shipping industry will find its way out of the crisis and will be able to stand on its own feet again. Shipping is by far the most efficient form of transportation and inevitably, when the demand for goods and raw materials recovers, shipping will flourish again. The questions left to be answered are when and to what extent.■

Advantages of registration – significant reasons on why to use the Cyprus flag

Economic benefits

- No tax on profits from the operation or management of a Cyprus-registered vessel or on dividends received from a vessel owning company.
- No income tax on the wages of officers and crew.
- Low registration costs.
- Favourable tonnage tax scheme based on ship´s gross tonnage.
- No stamp duty on ship mortgage deeds or other security documents.
- Double tax treaties with 43 countries.
- No exchange control and freedom of movement of foreign currency
- Full protection for financiers and mortgagees.
- Low set up and operating costs for companies.

Other advantages

- EU flag
- Classification of Cyprus flag in the White List of the Paris and Tokyo MOUs and exclusion from the "List of Targeted Flag States" of the US Coast Guard resulting in fewer inspections of the ships and less delays at the ports of both MOUs and of the US.
- Maritime offices in New York, London, Rotterdam, Piraeus, Brussels and Hamburg offering services to Cyprus ships.
- A network of local inspectors of Cyprus ships, covering important ports worldwide in order to ensure efficient and effective control of Cypriot vessels and to avoid detentions by port state control.
- Signatory to all international maritime conventions on safety and pollution prevention.
- Bilateral agreements with 23 countries, through which Cypriot ships receive either national or favoured nation treatment in the ports of other countries. Those agreements with labour supplying countries provide for specific terms of employment which are beneficial to both the ship owners and the seafarers.
- Efficient and qualitative provision of services by the Department of Merchant Shipping

The Voice of OECD Business

Food and Agricultural Policies for a Sustainable Future: Responding to Global Challenges and Opportunities

In its formal statement submitted to Ministers in advance of the 25-26 February OECD Agriculture Ministerial, the BIAC Food and Agriculture Committee highlights business priorities for OECD action in addressing the challenges and opportunities facing the food and agriculture sector

Introduction

BIAC appreciates the increasing political pressure for addressing food and agricultural issues, as evidenced by the G20 Leaders' Statement at the Pittsburgh Summit in September 2009 and the FAO World Food Summit in November 2009. This political pressure must not fade.

In BIAC's view, the 2010 OECD Agriculture Ministerial meeting, which comes 12 years after the previous meeting of this kind in 1998, is an excellent opportunity for Ministers to strengthen the food and agriculture system's position as a top international policy priority, and to create a forward-looking vision for related policies and OECD activities.

The following pages outline the OECD business community's perspectives and recommendations concerning major challenges and opportunities facing the food and agriculture system, as well as proposals for future OECD analysis.

Addressing the challenges and opportunities facing the food and agriculture system

Despite international efforts over past decades, millions of people are still not food secure. Water resources, volatility in global markets, changing trade policies, innovation, climate change, land use changes, as well as many other variables, continue to impact food security.

In view of the growing challenges that threaten food security, it is therefore increasingly essential to seize opportunities to address these challenges. BIAC's key overarching messages to Ministers for addressing these challenges are the following:

- Consider challenges in the food and agriculture sector in a broader perspective. It is increasingly important to address interactions between sectors and global challenges and to ensure policy coherence between all relevant decision-makers, such as international governmental organisations, national governments and ministries, as well as business and civil society.
- Consult and work together with the business community and other stakeholders in order to inform debates and develop sustainable and broadly-supported policies for a stable and predictable investment environment. Public-private cooperation and multi-stakeholder dialogue will be essential for encouraging much needed investment and capacity-building in the food and agriculture system.
- Strongly consider how to implement food and agriculture policies. The Ministerial meeting is an occasion for Ministers to go beyond simply updating the 1998 shared goals and policy principles. We recommend that Ministers consider how to implement policies to address the challenges facing the food and agriculture system in the broader context of limited resources and other global challenges.
- Call upon the OECD to carry out new forward-looking activities that benefit from the Organisation's added value. The OECD holds significant added value vis-à-vis other international organisations in addressing challenges facing the food and agriculture system. The OECD's cross-disciplinary and evidence-based approach, together with the institutional involvement of its formal advisory bodies (BIAC and TUAC), as well as other civil society organisations, provide the Organisation with a solid ability to objectively inform policy debates and to generate policy recommendations for a sustainable food and agriculture sector.

Further to these transversal BIAC messages, BIAC recommendations on specific challenges are presented in the following paragraphs.

Population and income growth

The number of undernourished persons has increased since the mid-1990s, to approximately 15% of the world population in 2008[1]. As the world population increases to an estimated 9 billion by 2050, ensuring food security will become ever more important. In developing countries, this could mean increasing food availability by almost 60% by 2030, and by 100% by 2050, equivalent to a 42% and 70% increase in global food production respectively[2]. Moreover, we have seen reductions in yield increases in previous decades, which could result in a situation where demand could grow faster than supply in coming years[3].

Population increase and income growth in emerging economies are associated with changes in diets in certain countries (such as China and India), where there is rising demand for meat products. This, in turn, puts additional demand on water resources and increases emissions of greenhouse gases (GHG).

OECD countries, together with emerging and developing countries, must develop policies for increasing agricultural productivity to meet rising food demand, and this must be carried out in a sustainable way, using best practices with advances in efficiency and innovation.

Trade and export restrictions

Policy-makers must address the issue of market distortions and work towards creating truly open markets. Trade barriers in the agriculture sector adversely affect all countries by impeding innovation, investment and economic growth. Additional policies intended to protect national markets, such as price controls and export restrictions, will discourage the necessary additional investment in agricultural production, impede access to agricultural raw materials and threaten food security. Concluding the WTO Doha Development Round will therefore be a key policy priority to boosting global food security.

During the 2007-08 price spike in world commodity markets, there was a significant increase in applying export restrictions to agricultural raw materials exports in order to avoid domestic food shortages[4]. The issue of access to raw materials and trade restrictions should be carefully considered, since limiting access has direct implications for the food industry, retailers and consumers.

Environment and climate change

The contribution of agriculture to global GHG emissions, in particular in the areas of methane and nitrous oxide, is considerable and will require increased attention in the future[5]. To prevent against conflicts with policies that address other global challenges, such as increasing food production to address food security, we need to look for "win-win policies".

Importantly, both mitigation and adaptation will need to be considered, as already small changes in climate change can have significant impacts on agricultural production. Preparing agriculture for adaptation should therefore go hand in hand with proactive mitigation strategies. Research is already being carried out in order

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to develop varieties of crop plants which can successfully grow in changing climates and have the potential to increase agricultural productivity.

Innovation in agriculture will be essential in addressing climate change. Innovation efforts should include focus on new crop varieties, crop protection, innovative water management, responsible use of fertilizers, soil conservation, and adjustment in farming practices, etc. Increasing farm productivity on existing land should be a top policy priority as it is the most productive and environmentally-friendly option available, and will address issues such as biodiversity, carbon sinks, and deforestation. A predictable and sound policy framework is necessary for the private sector to be able to make its contribution most effectively.

"Innovation and technology will also play a key role in enhancing global food security, by increasing production from existing farmland, rather than by increasing the amounts of cultivated land"

Food security and environmental protection are not mutually exclusive goals. Integrated agriculture based on the judicious use of technology and inputs (such as seeds, manure, fertilisers and crop protection products) and good agricultural practices can increase farm production in a sustainable way.

Competing claims and resource scarcities

The food and agriculture sector is facing increased competition from other sectors for access to land, water, nutrients, and energy sources, which are expected to become further affected by the impacts of climate change, possibly leading to greater volatility in commodity prices.

For example, agriculture is particularly dependent on a sound water management system, given that in many OECD and non-OECD countries agricultural production consumes approximately 70% of the water supply for irrigation purposes[6], and thus particular attention needs to be paid to developing sustainable water management systems and how to manage growing water consumption in other sectors. Competing uses for other resources, such as land (eg. for biofuels production), should also be addressed, since this will affect food supply and commodity prices[7]. We would also recommend assessing the opportunities for renewable energy which do not compete with food production (such as solar, wind, and the use of residues, waste and lignocellulosic material).

Policy-makers should take into account the interrelations between competing demands for limited resources and the impact on agricultural production. Policy coherence will be essential in this effort. Policy-makers should always consider the full lifecycle impacts related to use of natural resources in order to fully understand their impacts on the food and agricultural system.

Innovation and technological change throughout the supply chain

Meeting the above mentioned challenges will depend in large part on the ability to raise agricultural productivity. This will only be possible through innovation in a wide range of fields, including breeding technologies and biotechnology; but also agricultural practices, farming techniques and existing agricultural tools. Specific examples include: improved seeds; integrated pest management; agronomic biofortification; improved water management; leveraging information technology for agriculture; and enzyme applications.

Innovation and technology will also play a key role in enhancing global food security, by increasing production from existing farmland, rather than by increasing the amounts of cultivated land. Policy-makers should focus on sustainable production and supply, which involves public-private collaboration and modern technologies integrated with local and traditional knowledge. This requires appropriate policy frameworks to be in place and investment in R&D. Policy-makers should look at the returns on investment in agricultural research in order to determine the most cost-effective options in which to invest in the future.

Policy-makers should work to address public perception issues, and should work to improve education and capacity building in both developed and developing countries within an overall enabling, stable and predictable regulatory framework. This should include a high quality intellectual property system to protect investment and thus encourage innovation. Policy-makers should focus on building capacity (both generic and targeted) R&D, accompanied by improving access to information. In terms of R&D, policy-makers should encourage human capital in information technology, applied information sciences, agricultural sciences, soil sciences and related disciplines. It is also important to boost capacity for dialogue and partnership in order to better understand technological change and raise awareness about the need to address food security. Public-private partnerships, if properly designed, can play an important role in this area.

Future direction for the OECD

We encourage ministers at the 2010 OECD Agriculture Ministerial meeting to not only agree on and set forth policy principles and means by which to implement them, but to also take this opportunity to reshape the OECD Committee for Agriculture programme of work and enable it to respond to the challenges and opportunities facing the food and agricultural system.

As a general principle, the OECD, together with the increasing involvement of non-member economies, should concentrate on generating analysis that highlights the added value of the OECD in relation to other international governmental organisations, such as the FAO and UN.

BIAC therefore proposes the following suggestions for the 2011-12 Programme of Work for the OECD Committee for Agriculture:

- Develop guidance to countries to counter against traditional "silo approaches" and highlight the necessity of bringing together different government ministries and international organisations for a more holistic approach. Work on improving policy coherence between the food and agriculture system and other policy areas should be a priority.

- Address climate change and foster dialogue among different stakeholders and provide fact-based analysis on both mitigation and adaptation opportunities in the food and agriculture system.

- Concerning the OECD output area "Agriculture Sustainability", we support a change to "Agriculture Sustainability and Growth", and the outputs of this work should provide input to the OECD Green Growth Strategy. In our view, this output area should become a top priority area of the Committee for Agriculture.

- Address resource scarcities, including water and competing demands issues. This should take a lifecycle analysis approach.

- The OECD's current output area "Agriculture Policy Reform" should be renamed to also reflect food policy. BIAC supports a new title of "Food and Agriculture Policy".

- With regards to the OECD output area "Agriculture and Trade", BIAC supports a renewed title of "Agriculture, Trade and Development" to highlight the key role that agriculture plays in development.

- Work closely with BIAC and other stakeholders on these topics, keeping them well informed in advance about related meetings and projects.

Conclusion

BIAC urges ministers at the 2010 Meeting of the OECD Committee for Agriculture at Ministerial Level to take advantage of the renewed

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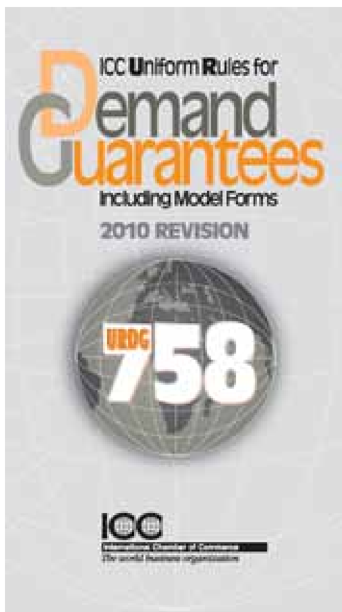
political momentum for addressing food and agriculture challenges, and to develop a ministerial output document that focuses on both policy principles and policy implementation. Priority areas for the output document should, in our view, include strengthening policy frameworks for investment and trade, increased agricultural production, innovation, and sustainable development. Due attention should be paid to ensuring policy coherence between international governmental organisations, national governments and their ministries. We also encourage ministers to set out recommendations for the 2011-12 Programme of Work for the OECD Committee for Agriculture that will highlight the added value of the Organisation. BIAC stands ready to provide continued support and business input to such activities. ■

1. *OECD-FAO Agricultural Outlook 2009-2018, p62*
2. *OECD-FAO Agricultural Outlook 2009-2018, p62*
3. *UNEP (2009) "Towards sustainable Production and Use of Resources: Assessing Biofuels – http://www.unep.fr/scp/rpanel/pdf/Assessing_Biofuels_Full_Report.pdf*
4. *OECD Summary Report of the Raw Materials Workshop (27th January 2010) – http://www.oecd.org/dataoecd/7/52/44489848.pdf*
5. *2010 OECD Committee for Agriculture at Ministerial Level, Background Notes*
6. *Ibid.*
7. *OECD-FAO Agricultural Outlook 2008-2017*

ICC Revises Demand Guarantee Rules

The long-awaited revision of the ICC Uniform Rules for Demand Guarantees (URDG) will enter into force on 1 July 2010. Destined to become the international standard for all demand guarantee practice, the rules apply to trillions of dollars of guarantees securing monetary and performance obligations in a wide array of international and domestic contracts.

The URDG provide a framework for harmonizing international practices by setting out the liabilities and responsibilities of trading partners at each key stage of the lifecycle of independent guarantees and counter-guarantees.



The original rules published in 1992 were adopted by the International Federation of Consulting Engineers in their model guarantee forms and later incorporated by the World Bank in all of its unconditional guarantee forms. They have also been endorsed by the United Nations Commission on International Trade Law, and national lawmakers have used them as a model for independent guarantee statutes.

Comprising 35 articles the new rules, formally known as URDG 758, contain new definitions and interpretations to provide greater clarity and precision as well as the solution to non-documentary conditions, asymmetrical guarantees and counter-guarantees. The new version does not merely update URDG 458; it brings demand guarantees into the 21st century with rules that are clearer, more precise and more comprehensive.

"The revised URDG rules are the latest example of ICC's leadership in writing the rules that govern some $14 trillion of international trade," said ICC Chairman Victor K Fung. *"Since its founding in 1919, ICC has been writing rules to facilitate cross-border trade and investment. ICC rules are globally accepted in the fields of banking, customs, marketing, advertising and trade finance."*

The revision also includes innovative treatments of payment contingencies and more precise language for determining whether a presentation made under a guarantee or counter-guarantee, be it paper-based or electronic, is a complying presentation. These changes are expected to curb the rate of rejection of demands and increase the certainty of the instrument.

The new version is also innovative in that it features a number of original treatments for payment contingencies dictated by the development of practice and the need to avoid disputes.

"This collective effort has borne fruit as it has produced rules that reflect a broad consensus among bankers, users, and all members of the guarantee community," said ICC Secretary General Jean Rozwadowski. *"It is the result of an ambitious project to create a new set of rules for the 21st century that is clearer, more precise, and more comprehensive, offering the fairest balance yet between the parties' competing interests and doing so in innovative ways."*

In international sales, whereas a documentary credit assures the exporter of being paid upon the presentation of complying documentation showing that shipment is made, a demand guarantee provides protection to the importer against non-performance, or late or defective performance, by the exporter.

The revision of the URDG, the first in 18 years, spanned two and a half years and was a cooperative effort by the ICC Commissions on Banking Technique and Practice, and Commercial Law and Practice. Both are made up of representatives from banks, companies and law firms worldwide.

It was conducted under the stewardship of the ICC Task Force on Guarantees, a standing body of experts from 26 countries. *"The new rules are destined to become the international standard for demand guarantee practice,"* said Georges Affaki, BNP Paribas, who chaired the task force. *"By setting uniform standards, the URDG level the playing field among banks and businesses in all countries and sectors. This is the antidote we need to bring back confidence into international trade in the aftermath of the financial crisis."*

The newly revised rules have been published and are now available for purchase from the ICC bookstore, giving practitioners a chance to familiarize themselves with the extensive changes before they come into force on 1 July. The new book includes a clear layout of the examination of the demand process and a check list of drafting recommendations and ready-to-use model forms.

About ICC

The International Chamber of Commerce is the largest, most representative business organization in the world. Its thousands of member companies in over 120 countries have interests spanning every sector of private enterprise.

A world network of national committees keeps the ICC International Secretariat in Paris informed about national and regional business priorities. More than 2000 experts drawn from ICC's member companies feed their knowledge and experience into crafting the ICC stance on specific business issues.

The United Nations, the World Trade Organization, and many other intergovernmental bodies, both international and regional, are kept in touch with the views of international business through ICC. ■

For more information please visit: www.iccwbo.org

Counterfeiting and Piracy Endanger Global Economic Recovery

Top government officials, business leaders and senior law enforcement authorities meeting in Cancun, Mexico urged national and international political and business leaders to step up actions against counterfeiting and piracy to help boost global economic recovery. The call for increased action came at the Fifth Global Congress on Combating Counterfeiting and Piracy held in Cancun from 1-3 December.

The international event brought together more than 800 delegates from 80 countries to share proposals for disrupting and curbing the worldwide illicit trade in counterfeit and pirated goods, identify more innovative and effective solutions and build upon successful strategies already in place.

The Fifth Congress was hosted by INTERPOL and the Mexican Institute of Industrial Property (IMPI), with support from the World Customs Organization (WCO) and the World Intellectual Property Organization (WIPO), the International Chamber of Commerce (ICC) through its Business Action to Stop Counterfeiting and Piracy (BASCAP) initiative, the International Trademark Association (INTA) and the International Security Management Association (ISMA).

The Organization for Economic Co-operation and Development (OECD) presented updated data indicating that international trade in counterfeit and pirated goods has increased to more than US $250 billion, almost 2% of world trade, up from US $200 billion reported in 2007. Other data released at the Congress showed that economic losses from counterfeiting and piracy is costing the economies of the G20 countries more than €100 billion, and putting 2.5 million legitimate jobs at risk. Another report released at the Congress showed that 80% of consumers admit they regularly buy fake or pirated products, with little remorse or concern about the consequences of those purchases.

Speakers presented a range of new approaches for more effectively combating counterfeiting and piracy through enhanced co-operation and co-ordination and increased public and political awareness of the issue. New perspectives on improving legislation and enforcement measures to deter and punish those involved in the domestic and international trade of counterfeit and pirated goods, and the sale of these illicit products over the Internet were also presented. An important new focus at the Congress was the responsibility of third parties who knowingly assist counterfeiters in the sale or distribution of fake and pirated goods.

"A recurring theme of this Congress and a constant characteristic of counterfeiting and piracy is the central role of transnational organized criminals," said John Newton, responsible for INTERPOL's Intellectual Property Rights programme. *"They commit these crimes without a care about the often deadly effect of products, including fake medical products and dangerous electrical products, on unknowing consumers. Fortunately another feature of the Congress was the clear determination of law enforcement agencies and customs worldwide to consistently target these criminals wherever they are."*

"International leaders from the public and private sectors and international agencies represented in Cancun have provided new and more effective strategies for combating counterfeiting and piracy," said Jorge Amigo, IMPI Director General. *"As these leaders and others return to the 80 countries represented at this Congress, we hope the spirit of collaboration and cooperation that was so evident in Cancun, will continue and lead to concrete actions that will reduce the threats to consumers and our economy in Mexico, and around the world."*

Yo Takagi, WIPO Assistant Director General, representing WIPO Director General Francis Gurry at the event, said that the Global Congress was an important forum for exchanging views and experiences on the challenges presented by the global trade in counterfeit and pirated goods. He underlined the critical importance of international co-operation in identifying effective actions to disrupt and curb this illegal trade. Mr. Takagi reaffirmed WIPO's commitment to a more inclusive, development-oriented and balanced approach to promoting greater respect for IP rights with a view to identifying solutions that make a difference.

WIPO will be the chair for the Sixth Global Congress. WIPO announced it will be co-hosting this event in Paris in February 2011 with the French National Institute for Industrial Property (INPI).

"Consumers around the world, especially those from vulnerable communities, expect the Congress to deliver tangible strategies that will protect them from harm; the way forward reached by the Congress which I have been following closely will, I am quite certain, meet their expectations," said WCO Secretary General Kunio Mikuriya. *"Up-skilling the risk analysis and interception techniques of Customs officials through effective capacity building will assist the global Customs community to meet its commitment to combating the cross-border trade in dangerous counterfeit goods and fake medicines, and enhance implementation of the WTO TRIPS Agreement,"* Mr Mikuriya added.

David Benjamin, Co-Chair of BASCAP and Senior Vice President Anti-Piracy - Universal Music Group, emphasized that protecting intellectual property is an essential part of attracting investment and job development. *"This Congress demonstrated that there is some momentum building in terms of growing recognition that counterfeiting and piracy are costing all of us tens of billions of dollars and millions of jobs lost or at risk,"* he said. *"However, we must now build on this*

The Global Congress on Combating Counterfeiting & Piracy

About the Congress

The Global Congress on Combating Counterfeiting and Piracy is a unique, international public private sector partnership that is united in its efforts to identify solutions and facilitate their implementation against the growing menace of the illegal trade in counterfeiting and piracy.

The Fifth Global Congress on Combating Counterfeiting and Piracy was held in Cancun, Mexico 1-3 December 2009. The Sixth Global Congress is scheduled to take place in Paris, France 2-4 February 2011.

The Congress is led by a Steering Group formed after the First Global Congress hosted by the World Customs Organization (WCO) at its headquarters in Brussels in May 2004. The Steering Group is chaired, on a rotating basis, by the WCO, INTERPOL and the World Intellectual Property Organization (WIPO). The private sector is represented on the Steering Group by the International Chamber of Commerce (ICC) through its BASCAP initiative, the International Trademark Association (INTA) and the International Security Management Association (ISMA).

The Steering Group, based on the input of its member organizations and delegates attending the First Global Congress, determined that its purpose would be to raise awareness of the growing problem of counterfeiting and piracy, share information, develop strategies to combat the illegal trade and identify practical actions and potential solutions. To date, the Steering Group has convened five Global Congresses and four Regional Congresses that have brought together global political and business leaders and experts from law enforcement, the judiciary, academia and the private sector to share strategies, program concepts and identify priorities for action. An "Outcomes Statement", capturing the recommendations and suggestions, has been produced following each Congress.

The Global Congress has become the premier international forum for shaping practical strategies to combat counterfeiting and piracy as evidenced by the prestigious speakers and growing numbers of delegates attending each successive Congress.

momentum and not let current economic pressures detract from the important work that needs to be done."

Richard Heath, President of INTA and Vice President of Unilever PLC, said it was evident from the three days of discussions President of that much had already been done to combat counterfeiting and piracy. He emphasized, however, that more needed to be done at the global and local level. *"From an industry perspective, we need to not only continue, but increase collaboration with each other and with governments to improve enforcement, enhance legislation and educate and protect consumers from the dangers of counterfeiting,"* he said. *"INTA stands ready to work with our industry colleagues and government to effectively combat this growing problem."* ■

INTERPOL

Combating Transnational Organized Counterfeiting and Piracy

Ronald K Noble is the INTERPOL Secretary General

INTERPOL's Commitment to Combating Transnational Organized Counterfeiting and Piracy Is Accelerating and Consistently Delivering Tangible Benefits

We started this global effort against counterfeiting and piracy with the First Global Congress held in Brussels in 2004. Despite the different challenges we have faced over the last five years, global awareness about the nature and extent of counterfeiting and piracy has risen significantly and continues to grow[1]. This, for me, is one of our major achievements and a testament to our strong commitment to this endeavour.

While piracy and counterfeiting remain significant crime challenges for law enforcers and for the business community worldwide, the vigorous partnership between the public and private sector member organizations represented on the Global Congress Steering Group and other stakeholders has made a real difference. It is clear that governments, international organizations, police, customs, cross-industry representative bodies and affected industries now treat counterfeiting and piracy with the seriousness it deserves.

For any partnership to be successful, it is necessary for each partner to ensure that strategic intention is translated into concrete action. INTERPOL's fundamental role within the Global Congress Steering Group is to provide guidance and support to the international police community in the fight against counterfeiting and piracy. INTERPOL consistently does this by initiating, facilitating and coordinating collective action for police and other stakeholders in its member countries; we do so often using our I-24/7 global police communications system.

INTERPOL's HQ's commitment to combating transnational IP crime is clear. With six officers assigned full-time to this important task and a seventh, from the French customs authorities, to join in January 2010, we are going to be able to do even more.

INTERPOL's strong partnership with the World Health Organization's International Medical Products Anti-Counterfeiting Task Force (IMPACT) since 2008 has reinforced the important leadership role of the two Organizations in coordinating the efforts of the international community as we collectively strive to make the world a safer place against counterfeit medical products.

In Africa this year, eight countries – Kenya, Lesotho, Malawi, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe – have been at the forefront of regional efforts to combat counterfeit medical products under the umbrella of the IMPACT programme. Coordinated operations in these countries, involving some 500 representatives from police, customs, drug regulatory authorities, immigration and other agencies, inspected pharmacies, supermarkets and wholesalers. They also seized a significant quantity of counterfeit and illicit medical products. These included antibiotics, anti-fungal, anti-malarial medicines, steroids and oral contraceptives, all of which pose a significant threat to public health.

Our operations also target those in the virtual world. The internet is no longer a safe haven for criminals who peddle dangerous counterfeit medicines. In response to an ever-increasing number of internet websites supplying dangerous and illegal medicines, Operation PANGEA II, was conducted from 16 to 20 November of this year. It involved 25 countries, focusing on the three principal components used by an illegal website to conduct their trade – the Internet Service Provider (ISP), payment systems and the delivery service.

During the operation, internet monitoring revealed 1,208 websites engaged in illegal activity, 106 of which have now been taken down. In addition, more than 19,000 packages were inspected by regulators and customs, 1,860 packages were seized and nearly 167,000 illicit and counterfeit pills were confiscated. In addition, a total of 46 individuals are currently under investigation for a range of offences including illegally selling and supplying unlicensed, counterfeit or prescription-only medicines.

The net result of these developments is that the INTERPOL IP Crime Programme has gone global and it has brought the fight to the counterfeiters on every level and in every region of the globe, thanks to the consistent application of our integrated training and operational enforcement model to all INTERPOL-led regional interventions in transnational IP crime.

Working closely with the World Customs Organization, other strategic partners and the private sector, these interventions have taken place in Africa, Europe, SE Asia, the Middle East and South America. For example, the different phases of Operation Jupiter, carried out in seven countries in South America since 2005, have resulted in nearly 700 arrests and in the seizures of all types of counterfeit and pirated goods worth an estimated 300 million US dollars. In 2010, Operation Jupiter will cover the whole of South America and be extended into Central America!

These achievements provide unequivocal evidence that dynamic, robust cross-industry law enforcement partnerships work and are the key to bridging boundaries to deliver shared solutions for combating transnational IP crime. Good as they are, these results are only the beginning as INTERPOL and our strategic partners steadily increase our capacity to provide police and other IP crime investigators with the tools and training they need to make a difference where it counts – at an operational level in all 188 INTERPOL member countries.

INTERPOL has progressively augmented its commitment to training all IP crime investigators and investigation managers. The 5th INTERPOL one-week IP Crime Training Course held in November brought the number of police, customs and drug regulatory body middle managers trained to lead transnational investigations to 307 from over 75 INTERPOL member countries. This figure does not include the other IP crime investigators who have attended the annual International Law Enforcement IP Crime Conference and those who have participated in pre-operational deployment training over the last two years.

However, even this is not enough! A permanently accessible resource is required to provide continuity and to make this high quality training widely available. This is where the INTERPOL IP Crime Investigators College (IIPCIC) can make a difference. This fully interactive College developed in partnership with UL University[2] is mandated to develop, coordinate and administer training programmes to support INTERPOL-led international efforts to prevent, detect, investigate and prosecute transnational organized IP crime.

The College will serve the needs of INTERPOL's partner organizations and other key stakeholders. It was launched in October with the production of the prototype module *"Health and Safety Consequences of Intellectual Property Crime."* Modules will be produced in the four INTERPOL languages and also in Mandarin to ensure that the materials are made available to our Chinese law enforcement officials.[3] The next milestone is to produce the five Introductory Level modules consisting of some eleven lessons by the end of 2010.

In conclusion, INTERPOL's commitment to combating transnational organized counterfeiting and piracy is accelerating and consistently delivering tangible benefits. The IP Crime Programme is providing proactive international leadership, innovation and is enjoying success with our equally committed public and private sector partners.

Nevertheless, there is still an urgent need for all of us to better respond to the global problem of counterfeiting and piracy. I ask everybody to work with the Global Congress Steering Group organizations and our hosts to identify how we can individually and collectively achieve even greater wins at disrupting counterfeiters and pirates and at bringing them to justice. Together we can and should reinforce the message that counterfeiting and piracy are serious crimes that will be vigorously investigated, prevented and prosecuted by us all. ■

1. International trade in counterfeit and pirated products could have been up to USD 200 billion in 2005. This total does not include domestically produced and consumed counterfeit and pirated products and the significant volume of pirated digital products being distributed via the internet. If these items were added, the total magnitude of counterfeiting and piracy worldwide could well be several hundred billion dollars more. (Source: OECD, 2007)

2. UL University is the training wing of Underwriters Laboratories, Inc. UL's global role is to test and certify the safety of both consumer and industrial products and is one of the leading certification bodies in the world.

3. According to statistics collected by the United States and European Commission TAXUD circa 85 per cent of all seizures made by customs officials in the United States and the European Community in 2007 and 2008 originated from China.

We Need a Development-Oriented Approach to Building Respect for Intellectual Property

Yo Takagi is an Executive Director of the World Intellectual Property Organization

On behalf of the Director General of the World Intellectual Property Organization (WIPO), Francis Gurry, I wish to renew WIPO's support and commitment to the objectives of the Fifth Global Congress on Combating Counterfeiting and Piracy. Since the first Congress was held in Brussels on May 2004, WIPO has been working together with INTERPOL, WCO, and the private sector represented by ICC-BASCAP, INTA, and ISMA to strengthen our collaboration. We are delighted to see this unique public/private sector partnership strengthened over the last five years.

We are in the midst of a world economic downturn. We have received signs of recovery in a few countries but they are weak and uncertain with the jobless rate surging. The rest of the world has still been struggling with recession, despite huge public investment for economic stimulation. Lessons that we learned from our history is that it is only the enhancement of productivity that would allow us to get out of economic recession. It is only new ideas, technologies, innovation and creativity that would allow us to create new jobs.

In this century of knowledge-based economy, efforts have been made by a number of countries to transform from resources-based and commodities-based economies into knowledge-based economies with a solid value chain and mutual trust between consumers and suppliers of new products and services. The current recession has encouraged those countries to speed up their transformation.

It is in this climate and context that we are meeting here and see escalating trade in counterfeit and pirated goods which are spreading out to all corners of the world. We have to find better strategies, practical and realistic measures in combating piracy and counterfeiting. WIPO wishes to renew its firm commitment to this challenge and call for stronger collaboration. WIPO is pleased to continue to avail its expertise in intellectual property to you, as piracy and counterfeiting have become more sophisticated and complex.

I wish to take this opportunity to share with you some thoughts and recent evolution at WIPO.

From the perspectives of intellectual property, piracy and counterfeiting activities are threat to the integrity and proper function of socio-economic system for supporting innovation and creativity. An intellectual property system is an integral part of the socio-economic system. The impact of piracy and counterfeiting goes beyond the horizon of the protection and enforcement of IP rights. Pirated and counterfeiting products are putting sand in economic engines. They are damaging consumers trust in genuine goods, and relationships with suppliers. With rampant piracy and counterfeiting worldwide, trademark systems could no longer assure consumers' trust in the quality of goods. Copyright system could no longer help creators and musicians to produce new music and movies for holiday seasons.

WIPO OMPI
WORLD INTELLECTUAL PROPERTY ORGANIZATION
ORGANISATION MONDIALE DE LA PROPRIÉTÉ INTELLECTUELLE

The problem of counterfeiting and piracy was perceived as a rich-poor issue five years ago. It is no longer. It is a problem also in any developing country where the government tries to establish their infant industry to get out from the poverty line.

Recognizing the complexity and scale of the challenge, last year, WIPO's 184 member states adopted an inclusive, development-oriented approach to building respect for intellectual property.

This is for restoring the proper role of the IP system as an integral part of socio-economic and knowledge infrastructure to support efforts of innovators and creators in both developed and developing countries that are expected to make contribution to the society in particular in difficult times.

This new strategic orientation emphasizes the need for a balanced, realistic and effective strategy that should get sustained and broad respect for innovation and creativity intellectual property across the globe.

It embraces issues that support effective compliance as well as broader societal interests, consumer protection and development-oriented concerns. By taking a fresh look at this challenge from a broader, more holistic perspective, we believe it will be possible to give new impetus to promoting and sustaining greater respect for innovated ideas, creative activities and, in that context, greater respect for intellectual

creation. The respect for intellectual property should then help curb the trade in counterfeit and pirated goods.

This strategic reorientation will enable us to improve understanding of the dynamics of the trade and its far-reaching impacts. It will further give a clearer assessment of what is being done, what needs to be done and how results can best be achieved in the future. We believe that such an approach will enable the international community to better calibrate its efforts and to use the available limited resources to best effect.

International cooperation is a prerequisite if we are to make progress in combating counterfeiting and piracy. The Fifth Global Congress offers an excellent forum for a rich exchange of experiences, views and ideas, about how to do more and how to do it more effectively with fewer resources. In the coming days, you will be addressing a range of important issues that, I am sure, will help to advance our shared goal to disrupt and curb this insidious trade and to restore widespread respect for creativity, trust and rules of other socio-economic system for our prosperity. ■

Cooperation, Collaboration and Coordination of Anti-Counterfeiting Enforcement Actions Are Key to Address the Problems of Counterfeiting and Piracy

Michael Schmitz is Director Compliance & Facilitation at the World Customs Organization

On behalf of Kunio Mikuriya, Secretary General of the WCO, and myself we want to thank the Mexican authorities and Interpol for the opportunity to address the opening session of the 5th Global Congress on Combating Counterfeiting and Piracy.

My remarks will focus on customs competence in the area of IPR enforcement. I must admit I never expected to have to address this particular issue before this audience but developments concerning customs IPR enforcement efforts over the past two years tell me that I should address the issue of customs competence in IPR enforcement.

Cooperation, collaboration and coordination of anti-counterfeiting enforcement actions are the means by which international organizations can best address the increasing concern over IPR violations. Customs, controls are the principle line of defence used by governments to protect their citizens from unsafe or dangerous consumer products moving through the international supply chain. This is particularly true when it comes to the issue of counterfeit goods that impact consumers' health and safety. Customs administrations are the single most effective enforcement tool governments have in the fight against IPR violations. To this end, the WCO is pleased to note that several recent international initiatives have focused on clarifying Customs enforcement authority. For instance, I note the prominent role seen for Customs IPR enforcement in EU Council Resolution 253/01. In particular I note the EU call to:

Make a survey of customs law and evaluate the improvements needed to the legal framework to improve action against counterfeit products.

The WCO would offer its draft Model Customs IPR Legislation that was unanimously approved by our 176 members states at our June 2006 Council Meeting as a response to this EU Resolution. This draft model legislation covers the treatment of counterfeit merchandise at importation, at exportation, in transit, in free zones and in warehouses. The WCO recognizes that nations that have signed the TRIPS Agreement are only required to deal with counterfeit merchandise at importation but the WCO also recognizes that every nation has the right, under its national legislation, to deal with counterfeit merchandise at exportation, in transit, in free zones and in warehouses even if that nation is a signatory to TRIPS.

While the largest IPR seizures are currently made at importation, when those seizures are traced back to their source, it is clear that even larger seizures could have been made when the goods were exported or in transit. Nations have pushed their borders out in order to more effectively fight terrorism and drug trafficking. If nations would apply the same methodology to international cargo at exportation, in transit and in free zones, it would increase the effectiveness of customs border enforcement against IPR violations.

For customs enforcement activity beyond importation, specific customs authority to deal with counterfeiting and piracy whenever the goods are under customs control is useful. While specific customs authority for dealing with IPR violations at importation, exportation, transit, free zones and warehouses is useful, almost all cross border transactions concerning counterfeiting or piracy will involve either a concealment of or a false declaration concerning the merchandise. These are customs offenses in and of themselves and can be prosecuted by customs even if the particular customs administration does not have specific authority vis-à-vis counterfeiting or piracy. Why is this so? Every nation has an absolute right to determine who and what crosses its national borders. This is a simple matter of national sovereignty and the instrument of this exercise of sovereign control is, and always has been customs. Indeed, national legislation generally nominates customs as the entity to enforce the laws and regulations of many other government departments at the border.

While some nations, whether TRIPS signatories or not, may want customs to focus on IPR importation enforcement only, no nation can require another nation to focus solely on IPR importation enforcement. Why? It is again a matter of sovereignty. Whether a nation is or is not a signatory to TRIPS, the right to do IPR enforcement at export, in transit, in free zones or in warehouses is within the sole discretion of each nation.

I must add a note of caution. While some customs administrations have been involved in IPR enforcement activities for over 30 years and the WCO itself has been involved in IPR enforcement activities for well over 25 years, in the past two years a number of countries have questioned the competence of customs in IPR matters. This issue of customs competence has been raised by some G20 countries. While the competence issue is usually raised in the context of customs' authority to make infringement decisions, there is a subtext that questions customs' authority, without specific legislative or regulatory authorization, to detain, control or seize cargo that may be infringing. This question was never raised by the G7/G8 but the G20 has eclipsed the G7/G8. While I understand that the number of customs administrations with specific IPR border enforcement authority is limited, I would refer you to the point I raised earlier in my remarks that almost every incident concerning counterfeiting or piracy at a national border involves an unlawful act (concealment or false declaration) and therefore, there is an underlying customs violation even if the customs administration has no specific IPR border enforcement authority. In addition, as a matter of national sovereignty, most nations have designated their customs administrations to enforce their national IPR legislation at the border.

The WCO is currently focusing on several core issues and priorities which can result in enhanced effectiveness of the efforts made by customs in combating counterfeiting and piracy. These priorities include:

- Enhancing cooperation, collaboration and coordination among national authorities concerned with IPR enforcement at the border
- Setting up an international communication network for the rapid exchange of information on counterfeit products among appropriate entities
- Promoting increased and more efficient coordination between international institutions involved in combating counterfeiting and piracy
- Sharing of best practices in IPR border enforcement among national customs administrations.
- Providing technical assistance and capacity building expertise in the field of IPR border enforcement to any WCO member requesting such assistance.

The WCO has always been a strong advocate of customs cooperation, collaboration and coordination with other national, regional and international governmental organizations that have border control responsibilities. The WCO has developed the Coordinated Border Management concept to ensure open and secure borders as a critical building block in our customs in the 21st Century Initiative. Coordinated Border Management provides for proper national and international cooperation, collaboration and coordination among the various authorities involved in border control activities. Coordinated Border Management also provides for proper national and international cooperation, collaboration and coordination of the various authorities involved in border management to ensure that borders are managed with maximum effectiveness and efficiency.

On a national level, customs administrations must work with their border partners in the national government to establish a "single window" to receive advance cargo information electronically, to distribute that electronic information to the relevant border control agencies in order to ensure the rapid release of legitimate cargo that has undergone a consistent and effective application of risk management regimes by all relevant border control agencies.

Due to the support the WCO received from its members the WCO Data Model Version 3 was approved by the WCO Council in June this year and will be released in December 2009. The Government Cross Border Data Reference message that enables the multi agency submission of data, including through the use of a "single window", was approved by UNCEFACT in July this year and work is underway to align the WCO Data Model Version 3 with the UNCEFACT Core Component Library over the coming months. This is the first business to all government electronic messages developed specifically for the "single window" environment.

Customs should also make effective use of search technology and best practices in cargo examination when risk analysis indicates such further actions are appropriate.

The WCO actively promotes cooperation, collaboration and coordination among international organizations having IPR responsibilities including the WTO, WIPO, OECD, World Health Organization, Universal Postal Union, Interpol, the G8 and the G20. The WCO has engaged in joint IPR enforcement operations with Interpol and the UPU and we work with the WHO on the smuggling of counterfeit cigarettes.

In addition to these activities, the WCO promotes the sharing of best practices in IPR enforcement through its Enforcement Committee and Permanent Technical Committee meetings. The WCO has an extensive capacity building and training programme that explains and promotes customs IPR border enforcement best practices. Private sector rights holders participate in our committee meetings and in our capacity building and training activities. The WCO also publishes an annual IPR Report that analyzes customs seizures of counterfeit merchandise.

For those customs administrations that do not have the ability to communicate with other customs administrations, the WCO has developed the Customs Enforcement Network Communication System or CEN COMM. CEN COMM is an internet-based, secure; encrypted communication tool for customs administrations and other appropriate entities to exchange information in real time.

However, there is a reality that we must all understand. Customs administrations worldwide face a trade facilitation trade security dilemma, on one hand there was, at least until the recent recession, the continuing growth in legitimate international trade, while on the other hand there is the illicit cross border movement of weapons of mass effect, drugs, counterfeit merchandise, dual use chemicals, small arms, nuclear material, undeclared merchandise, currency, cultural property, endangered species, pornography, trafficked human beings, hazardous waste, unsafe foodstuffs and dangerous consumer products. In addition, for 70% of our 176 member states, customs revenue provides a significant portion of national income so revenue collection is often the most important job customs performs for the nation it serves. So except for counterfeiting and piracy that impacts public health and safety, where does a Customs administration place anti-counterfeiting enforcement in its list of priority missions given by the nation it serves. While customs administrations stand ready to attack all forms of counterfeiting and piracy, it is a nation's government that will determine where those customs border enforcement efforts are focused. ■

More Immediate and Aggressive Action Required Against Counterfeiters

Mark Cobben, BASCAP representative and Regional Director, Americas, British American Tobacco

BASCAP is very proud to be a part of the outstanding public-private partnership that has organized this important Congress.

BASCAP has been involved since the beginning, and we are proud of the leadership role we have played in all four of the previous Global Congress events and the many regional events in between.

We wish to thank INTERPOL for hosting this Fifth Congress and to Secretary General Ron Noble for his personal involvement and support.

Thanks as well to the WCO and WIPO for their continued personal involvement and support in fighting counterfeiting and piracy, and the leadership they have continued to show in supporting these Global Congresses and the work of their staff on these issues.

We would also like to thank the Mexican government for co-hosting

this event, and for the leadership and involvement of IMPI in organizing this Congress.

This is the first Global Congress to be held in Mexico and the Americas more broadly. This is an important step for those of us in the private sector. We are encouraged by the progress being made against this critical issue in Mexico and the rest of the region, but clearly progress has been slower than any of us would like. I am hopeful that this Congress will identify new, creative approaches to achieve real results against these huge problems in the region as well as globally.

Everyone here recognizes that counterfeiting is a multi-billion dollar problem and that it costs trademark owners and governments millions, even billions of dollars, per year. But, first and most important, counterfeiting is a problem for the users of our products. I can assure you that this is the number one reason BASCAP members are so concerned about this issue and getting counterfeiters out of business.

Counterfeit products cheat customers of the quality they expect, and rob them of their shopping dollars. Counterfeiting also destroys trust in brands and in the manufacturers of legitimate products. It hurts the general public because their governments are losing tax revenues and diverting resources that could be spent on other, more important activities and benefits. In the tobacco industry, we estimate that Governments lose $20 billion annually in lost revenue through sales of illicit tobacco while tobacco manufacturers and the trade each lose $5 billion annually. So, it's not just a Big Business problem which many people try to make it out to be. It affects government revenue much more, therefore it is a problem for every citizen. It also exposes consumers to unsafe products.

While we are encouraged by the steps that have been taken and continue to be taken since the First Global Congress, there is much yet to be done. We need more action and more aggressive action, and we need it now.

For the tobacco industry, and many of the industry sectors represented here today, our priorities in the region include our continuing efforts to work with governments in the tri-border areas between Paraguay, Brazil and Argentina. For my industry, we are working to ensure more effective controls of those borders in an attempt to stop the smuggling of tobacco products from Paraguay.

However, we realise that the challenges in the region are not limited to the tri-border areas. To illustrate, I thought I would take this opportunity to tell you a real life story about an important country in the region. It is about Canada. Controlled by organized crime, every year 13 billion illegal cigarettes flood unimpeded into this country. One third of the cigarette market is illegal. Controlled by organized crime, young people are recruited into the smuggling trade and are targeted as potential customers. Most worryingly, however, this trade is fuelling drug, firearms and alcohol networks and Governments are losing billions of dollars.

What I would like to speak about is the inconvenient truth of Canada's tobacco industry today: over one third of the Canadian tobacco industry has been handed over to an illegal, unregulated, un-enforced and untaxed free for all.

Elements of this story highlight why we are here today: lost tax dollars, questionable product quality, eroded consumer trust, lost revenues.

How these cigarettes get into the marketplace is unique. Several First Nations Native Indian reservations straddle the Canada – US border. Day in and day out, trucks and boats carrying millions and millions of illegal cigarettes are delivering their illegal goods unhindered. Over 90% of the illegal cigarettes are manufactured on First Nations reserves in Quebec, southern Ontario, and on the US side of the border. Some are produced by operations that are unlicensed but surprisingly some are actually licensed by the Canadian government.

Most of the cigarettes are unbranded and sold in transparent plastic bags for between $6 and $15 for 200 cigarettes. Their legal and taxed cousins sell for between $60 and $80 for 200 cigarettes.

Some are branded to look similar to legal brands. Others have their own distinct brands. And still others are pure counterfeit.

I know what you are thinking – our profits are being threatened. It is true that the rampant sale of illegal tobacco impacts the bottom line of our subsidiary – Imperial Tobacco Canada. I know that few will shed a tear for the tobacco industry. But there are larger issues at play here. The unravelling of tobacco control in Canada has disastrous economic and social consequences.

In 2008, the federal and provincial governments together lost approximately $2.4 billion in taxes and that number is growing as the sale of illegal cigarettes grows. I don't think that in today's economic climate any government can afford to turn its back on billions of dollars in lost revenue.

In addition, left unchecked, this illegal activity is bringing crime into Canadian neighbourhoods.

The RCMP states that over 100 criminal groups with varying levels of sophistication are involved in this illicit trade. Compounding the problem is that 69% are also involved in drug trafficking, mainly marijuana and cocaine, and/or weapons trafficking.

In 2009 the Canadian Convenience Stores Association commissioned research outside high schools in Ontario and Quebec and found that the penetration of illegal tobacco amongst youth was as high as 48% in Ontario and 83% in Quebec.

It is easy to see why illegal tobacco is so attractive to kids. As I mentioned earlier, a teenager can buy 200 illegal cigarettes for as low as $6, compared to between $60 and $80 for the same number of taxed legal cigarettes. Furthermore, criminals selling illegal cigarettes do not ask for ID.

So how did this problem arise?

We believe that the Canadian federal and provincial governments are abdicating their responsibilities, proposing ineffective solutions and refusing to deal with the real problem. They choose to introduce politically expedient and opportunistic legislation which does nothing to address the monumental rise in illicit trade.

The illegal tobacco trade in Canada is a warning bell for governments and industry everywhere dealing with the counterfeiting and piracy issue. I hope that we all keep the Canadian example in our discussions over the next three days. We need to work together to identify the new strategies and creative ideas that will take us to the next level to solve this problem.

In contrast to the situation in Canada, I want to talk about Brazil and the effectiveness of the anti-illicit trade initiatives that have been implemented. Illicit trade in Brazil accounts for 27% of the Brazilian market. Despite the significance of the issue here, illicit trade is at the lowest levels ever (it was 33% a few years ago).

This is due to the steps taken by the Brazilian Government at fighting tax evasion in the tobacco sector through provisions including licensing, the implementation of an integrated control and monitoring system and the introduction of electronic invoicing for all cigarette manufacturers and distributors.

In addition, the Brazilian authorities have been making undeniable progress on border controls and law enforcement initiatives and continues to push Paraguay to implement the international standards of production, commercialization, taxation and fiscal controls.

In addition, I know that the Mexican Government and Congress have heard the warning from Canada, and I would also like to commend them for their wisdom and responsibility in deciding to raise tobacco excise tax in a gradual manner over the next four years. This, coupled with effective authentication technology and border controls, is the

best way to keep the criminals out. The excellent working relationship with the Mexican government is another example of the invaluable public-private partnership model which we hope the Congress will aim to achieve on a global footing in its discussions over the next few days.

As Ron Noble just highlighted in his remarks, there are new challenges since the Fourth Congress that threaten to divert attention and resources away from the fight against fakes. The critical economic crisis being felt around the world, by governments and by business, has created pressure to maintain the priority focus on fighting counterfeiters and copyright pirates. One goal of this Congress should be to show why this focus must be maintained and why it makes economic sense, even in today's financial crisis to continue to devote the attention and resources needed to stop these fakes and the criminals who sell them.

For my company, British American Tobacco, fighting illicit trade continues to be a top priority and we will not relegate the issue in our annual budget despite the economic downturn. We urge other businesses and governments to do the same. We have achieved a lot in the last few years and we cannot afford to lose momentum at this stage and destroy the fruits of our past efforts. It is tough but we have to fight to hang on, if not consolidate our position.

Greater awareness and education on the issue will continue to be a critical element of the battle, and to this end, we are very pleased to note that BASCAP has devoted significant resources to develop plans for a global awareness and education campaign. You will hear much more about this over the next few days, but I want to emphasize that we have approached this work with an attitude that our communications campaign will not be a proprietary effort, but rather something that we will share and make available to governments, private sector trade groups and others for their adaptation and reapplication. We are all in this fight together and this is one area where we can have the greatest impact and greatest reach by joining together to create greater awareness and more education of the risks and dangers of counterfeiting and piracy.

These Congresses are an essential step in maintaining focus on the issues, sharing steps that have been taken and exploring new opportunities for actions and collaboration. Industry is committed to find ways to improve the coordination and collaboration of our efforts, and to improve our ability to present a consistent voice to our government partners.

We also need more action to support important initiatives from our government partners, including initiatives being taken by Interpol, WCO and WIPO that you will be hearing about over the course of the Congress.

I also look to Congress to find specific solutions to combat the serious misuse of free-trade zones for the manufacture and trans-shipment of counterfeit products. The last Congress in Dubai went some way towards recognising the extent of the problem. What we need now is a focused plan of action to tackle the issue.

I also want to highlight the use of technology in securing the supply chain including the identification of counterfeit products and in verifying the tax collectable from sales of products. It is key for governments to recognise that while technology plays an important role in these processes, it is counter-productive for the use of any specific proprietary technology to be prescribed. It is more important to lay down standards that industry can adhere to. In addition, we are seeing an increasing number of governments looking into more enhanced tax collection methods and we believe Digital Verification is the way forward for this purpose. As I mentioned before, I applaud the efforts of the Mexican government and major industry players in the recent successful trial of a digital form of fiscal verification and authentication within the tobacco industry.

The companies that are members of BASCAP, including my company, British American Tobacco, are committed to be active participants in this process over the next three days and the months ahead. ■

Sale of Counterfeits over the Internet and Completion of the ACTA Negotiations Are Key Issues

Richard Heath, 2009 INTA President and VP Legal - Global Anti-Counterfeiting Counsel, Unilever

It is a pleasure and an honour for me to once again be addressing the Global Congress on Counterfeiting and Piracy, now in our 5th year. This forum continues to be critical for government, industry leaders and organizations like INTA to find leading policy and best practice solutions on effective measures against counterfeiting.

This year we have experienced a number of events that have or will have an impact on the anti-counterfeiting landscape:

- Just across the border to the North, a new administration has completed its first year in the United States and a new US IP Enforcement Coordinator was recently confirmed and has joined us here today,
- Newly appointed government officials in China are now in their second year of office,
- The Anti-Counterfeiting Trade Agreement (ACTA) is being negotiated by 35 countries and is expected to conclude in 2010
- And earlier this year, the new and unique EU Observatory for Counterfeiting and Piracy was launched by the European Commission.

This is by no means an exhaustive list as there are many initiatives at the regional and local level that impact the fight against counterfeiting and piracy.

However, we have also experienced, and indeed are still experiencing an economic crisis the likes of which have not been seen in our lifetime and to which none of us are immune. This has forced governments and businesses to take a closer look at their available resources and in the midst of all this, counterfeiters are constantly evolving their creative practices and the way they conduct their illicit trade to exploit the adverse economic conditions we find ourselves in.

The theme for this Global Congress is *"Bridging Boundaries for Shared Solutions"* and I am pleased to see more than 800 of us representing more than 80 countries are here today. Now more than ever, we need to collectively step up the fight against counterfeiting, especially at a time when counterfeiting networks and activities are transcending borders, utilizing the internet to sell their illicit goods, and taking advantage of loopholes across jurisdictions to conduct their illegal activities. We need to continue to strengthen and harmonize anti-counterfeiting laws and regulations, build capacity through the provision of additional judges, police and customs officials, build bridges between industry and government, encourage cooperative

partnerships amongst industry associations and last but by no means least we must deal with demand by educating consumers on the harms of counterfeiting.

I would like to take this opportunity to highlight a couple of issues that have been an important focus for INTA this year and that build on some of the discussions from the last Global Congress.

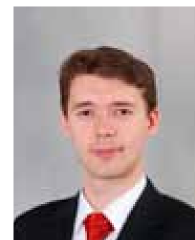
The first issue is the **sale of counterfeit goods on the internet.** This has become a convenient and easy channel through which counterfeiters can reach out to consumers all over the world thereby increasing the threats to economies and public health and safety and further facilitating organized criminal activity. While the link between the increased sales of counterfeits on the internet and the harms caused to businesses and the public is clear, the solution to the issue is complex and challenging.

International Trademark Association

INTA believes that industry stakeholders need to collaborate more closely with each other and with the enforcement authorities around the world to find creative and practical ways to tackle this problem. In this regard, INTA created two task forces last year to examine and develop recommendations on practical ways for trademark owners, online marketplaces, search websites and payment service providers to address the sale of counterfeits over the internet. The result was a set of best practices for trademark owners and online service providers to follow. This includes the provision of contact information for notifying online service providers about websites selling counterfeits – an important course of action for trademark owners attempting to have such websites taken down or to disrupt the sale of counterfeit products.

The second issue I would like to highlight is the **Anti-Counterfeiting Trade Agreement, also known as "ACTA,"** the negotiations for which were just getting underway when we held the 4th Global Congress in Dubai last year. Delegates will also recall that the very idea of a new treaty to address the problem was originally discussed and proposed at the 2nd Global Congress back in Lyon in 2005 so it's great to see one of the Congress' policy proposals now taking shape. At a time when counterfeiting networks and activities transcend borders, INTA believes that ACTA is a critical agreement that needs to be focused and set a higher gold standard of enforcement against counterfeiting and piracy. Since the start of the negotiations, INTA has partnered with another of the Global Congress founding fathers - the International Chamber of Commerce's Business Action to Stop Counterfeiting and Piracy (or BASCAP) to lead a Business Response Group (BRG) of more than 20 associations. The BRG's goal is to provide recommendations and expertise to the ACTA negotiators on issues such as criminal and civil enforcement and border measures, among others. We are grateful for the negotiators' consideration and we continue to stand ready to provide additional input. We also note that the next round of negotiations will be taking place in Mexico in January 2010 and congratulate the Mexican government for taking on this important issue. ■

Protection of Intellectual Property in Ukraine: The Way to the European and Global Communities



Oleh Furmanchuk LL.M is an Associate with Asters, Kyiv, Ukraine

The level of intellectual property protection in Ukraine

The national legal framework and government activities

Nowadays the system of intellectual property protection is entering its pre-final stage of development in Ukraine, towards compliance with the internationally accepted approaches to such protection. The crucial role of intellectual assets in the global economy growth determined the choice of innovative strategy by Ukraine in the 21st century. The important part of that strategy is the development of the national legal framework that includes adoption of the national laws and accession to international agreements that become part of the national legislation. The laws of Ukraine that regulate intellectual property protection are as follows (non-exhaustive list):

- Code on Administrative Infractions of Ukraine (7 December 1984);
- Law of Ukraine "On Protection of Plant Variety Rights" (21 April 1993);
- Law of Ukraine "On Protection of Rights to Trademarks and Service Marks" (15 December 1993);
- Law of Ukraine "On Protection of Rights to Inventions and Utility Models" (15 December 1993);
- Law of Ukraine "On Protection of Rights to Industrial Designs" (15 December 1993);
- Law of Ukraine "On Copyright and Allied Rights" (23 December 1993);
- Law of Ukraine "On Protection against Unfair Competition" (7 June 1996);
- Law of Ukraine "On Advertising" (3 July 1996);
- Law of Ukraine "On Protection of Rights to Integrated Circuit Designs" (5 November 1997);
- Law of Ukraine "On Cinematography" (13 January 1998);
- Law of Ukraine "On Protection of Rights to Goods Origin Designations" (16 June 1999);
- Law of Ukraine "On Distribution of Copies of Audiovisual Works, Phonograms, Videograms, Computer Software, Databases" (23 March 2000);
- Criminal Code of Ukraine (5 April 2001);
- Customs Code of Ukraine (11 July 2002);
- Civil Code of Ukraine (16 January 2003);
- Commercial Code of Ukraine (16 January 2003);
- Law of Ukraine "On State Regulation of Activities in the Sphere of Technology Transfer" (14 September 2006).

The normative framework on intellectual property protection is constantly evolving. Apparently, the most important recent legislative effort in Ukraine was the December 2008 restatement of Article 4 "Illegitimate use of designations" of the Law of Ukraine "On Protection against Unfair Competition" allowing for more efficient counteraction to parallel import. As restated, Article 4 stipulates that the use of a commercial name, a trademark or service mark, advertising materials, and other designations by a business entity without permission of another business entity that has already been using those or similar designations in its business activities, which resulted or may result in a confusion of interested parties with regard to business activities of those entities, is illegal. The earlier wording of the law less clearly defined the business entity competent to issue permissions whose activities could be confused with those of an infringer.

Thus, using more precise definitions trademark owners may hinder parallel import of goods, if the parallel importers use the trademarks of the manufacturers in an active way (advertising, etc.). There are also other legal means against parallel import that, however, go beyond the scope of this report.

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Table 1. Applications for industrial property objects in 1992 - 2009

Industrial property objects	Total number of applications filed, including:	Inventions			Utility models	Industrial designs	Integrated circuit designs	Qualified goods origin designations	Trademarks and service marks		
		Total	National procedure	PCT procedure					Total	National procedure	Madrid agreement
1992	1480	920	910	10	–	56	–	–	504	504	-
1993	21587	11684	10596	1088	–	443	–	–	9460	6226	3237
1994	15423	6687	5910	777	–	319	–	–	8417	4533	3884
1995	12674	5960	5117	843	125	312	–	–	6277	3322	2955
1996	12827	4893	3985	908	126	314	–	–	7494	3053	4441
1997	17631	6256	4980	1276	135	699	–	–	10541	4136	6405
1998	19390	6950	5560	1390	137	911	–	–	11392	5070	6322
1999	17580	7035	5657	1378	204	811	–	–	9530	4736	4794
2000	19951	7239	5861	1378	376	1135	–	–	11201	6272	4929
2001	24820	8813	7448	1365	434	1376	–	–	14197	8583	5614
2002	29214	10189	8806	1383	622	1806	1	9	16587	11322	5265
2003	35913	12605	11322	1283	839	2310	–	8	20151	13772	6379
2004	33138	5778	4356	1422	5232	1862	2	1	20263	13960	6303
2005	39291	5592	3842	1750	7286	2010	2	2	24399	16366	8033
2006	46335	5930	3788	2142	8171	2236	–	2	29996	20813	9183
2007	50461	6163	3766	2397	8870	2147	9	6	33266	23746	9520
2008	50665	5661	3113	2548	9636	2285	–	2	33081	22371	10710
7 months of 2009	23859	2842	1592	1250	5244	901	--	5	14867	9517	5350
Total	**472239**	**121197**	**96609**	**24588**	**47437**	**21933**	**14**	**35**	**281623**	**178302**	**103321**

The information is taken from the official website of the State Department of Intellectual Property: http://www.sdip.gov.ua/

Another legislative development in the sphere of intellectual property was the adoption of the Procedure of Appraisal of Intellectual Property Rights on 25 June 2008 that establishes the procedure for determination of the appraised value of proprietary rights to certain objects of intellectual property. Currently, the responsible authorities plan to draft the Procedure of Damages Calculation for Copyright and Allied Rights Violation and adopt a program of counteraction to camcording in the first half of 2010.

The legislative activity of the Ukrainian government was appreciated by the USA government, and resulted in moving Ukraine from the Priority Watch List to the Watch List in the "Special 301" Report 2008 due to improvements in intellectual property rights protection. As noted in the report *"the "Special 301" Report is an annual review of the global state of intellectual property rights protection and enforcement, conducted by the Office of the United States Trade Representative (USTR) pursuant to Special 301 provisions of the Trade Act of 1974. The 2008 Special 301 review process examined intellectual property rights protection and enforcement in 78 countries. Following extensive research and analysis, USTR designates 46 countries in this year's Special 301 Report in the categories of Priority Watch List, Watch List, and/or Section 306 Monitoring status".*

Ukraine is a party to the following international agreements in the sphere of intellectual property:

- Paris Convention for the Protection of Industrial Property (1883);
- Berne Convention for the Protection of Literary and Artistic Works (1886);
- Madrid Agreement Concerning the International Registration of Marks (1891);
- The Hague Agreement Concerning the International Deposit of Industrial Designs (1925) (the Hague Act of 1960 and Geneva Act of 1999);
- Universal Convention on Copyright (1952);
- Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (1957);
- International Convention for the Protection of New Varieties of Plants (1961);
- International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (1961);
- Convention Establishing the World Intellectual Property Organization ("WIPO") (1967);
- Locarno Agreement Establishing an International Classification for Industrial Designs (1968);
- Patent Cooperation Treaty (1970);
- Strasbourg Agreement Concerning the International Patent Classification (1971);
- Convention for the Protection of Producers of Phonograms against Unauthorized Duplication of Their Phonograms (1971);
- Vienna Agreement Establishing an International Classification of the Figurative Elements of Marks (1973);
- Budapest Treaty on the International Recognition of Deposits of Microorganisms for the Purposes of Patent Protection (1977);
- Nairobi Treaty on the Protection of the Olympic Symbol (1981);
- Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (1989);
- Trademark Law Treaty (1994);
- WIPO Copyright Treaty (1996);
- WIPO Performances and Phonograms Treaty (1996);
- Patent Law Treaty (2000);
- Singapore Treaty on the Law of Trademarks (2006).

In addition to the international obligations arising from the membership in international treaties the country also has to fulfil certain objectives in view of 2012 UEFA European Football Championship, which is to be held in Ukraine. Among those goals is the protection of UEFA and its commercial partners' intellectual property rights. Thus, in 2008 the Cabinet of Ministers of Ukraine created the Coordination Board on Issues of UEFA's Intellectual Property Rights Protection. The Board's objective is to cooperate with the relevant structures of UEFA in order to promptly react to violations of UEFA's intellectual property rights.

Organizational structure of the system of intellectual property protection

Ukraine has a multiple system of state authorities that secure the necessary level of intellectual property protection. This statement is equally true with respect to the three branches of the state power: legislative, executive, and judicial.

The only authority of the legislative power is the Supreme Council (*Verkhovna Rada*) of Ukraine. Therefore, the legislative direction of intellectual property protection is represented by the Sub-committee on Intellectual Property in the structure of the Supreme Council Committee on Science and Education.

Judicial branch is characterized by the specialization of courts in the sphere of intellectual property. In 2000 a Chamber of the High Economic Court of Ukraine was established to adjudicate cases related to the protection of intellectual property. The relevant panels were also created in the structures of local and appellate economic

Table 2. Protection documents included to the state registers in 1992 – 2008

Protection documents	Patents for inventions	Patents for utility models	Patents for industrial designs	Integrated circuit designs	Registered trademarks and service marks	International registration of trademarks and service marks under the Madrid agreement
1992	230	–	12	–	15	–
1993	1939	–	378	–	3075	1429
1994	4650	–	338	–	3316	1093
1995	1350	4	387	–	229	1943
1996	4270	24	240	–	1025	4564
1997	9121	99	392	–	1639	4258
1998	4336	161	725	–	1945	4703
1999	1294	194	871	–	3363	5618
2000	5772	222	1044	–	3339	4446
2001	11670	422	1186	–	4389	4286
2002	9178	440	1267	–	6642	5732
2003	10983	672	1474	–	7706	5103
2004	9907	1853	1436	2	9383	5853
2005	3719	7467	1569	1	11645	6899
2006	3705	8268	2061	2	13134	9396
2007	4060	9215	2213	4	15375	8298
2008	3832	9282	2503	2	15357	9459
Total	**90018**	**38323**	**18096**	**11**	**101577**	**83080**

The information is taken from the official website of the State Department of Intellectual Property: http://www.sdip.gov.ua/

courts.

The authorities of the executive branch that are entrusted with the function of intellectual property protection are the most numerous. In 2000 in the structure of the Ministry of Education and Science of Ukraine the State Department of Intellectual Property was established. Its main task is implementation of the state policy in the intellectual property sphere and drafting legislative instruments with regard to intellectual property protection. It also includes the Appeal Chamber that reviews the complaints on the decisions regarding applications for inventions, utility models, industrial designs, trademarks, integrated circuit designs, and goods origin designations (see Tables 1 and 2).

The other executive authorities are as follows:

- Ministry of Justice (takes part in drafting legislative instruments on intellectual property issues and is responsible for adaptation of the national legislation to the legislation of the European Union);
- Ministry of Internal Affairs (is engaged into preventive and investigative activities related to intellectual property infringements as well as takes part in drafting legislative instruments and amendments);
- Security Service (takes part in activities directed to protection of state secrets of Ukraine, assists to business entities in protection of their commercial secrets that are vital to the security of Ukraine);
- State Customs Service (controls the movement of goods containing intellectual property objects across the customs border, registers such goods, etc.);
- State Tax Administration (controls tax charges and payments of taxes in cases of import of goods and audio- and video production into the territory of Ukraine);
- Antimonopoly Committee of Ukraine (protects undertakings against unfair competition related to unlawful uses of intellectual property objects);
- State Committee of Ukraine for Technical Regulation and Consumer Policy (controls compliance with the consumer protection and advertising legislation).

Integration into WTO and EU

Being a part of the globalized world and situated at the crossroads of Europe and Asia, Ukraine consistently moves on its way of accession to global communities. Recently, Ukraine has achieved its goal of accession to the World Trade Organization (WTO), and became its 152nd member on 16 May 2008.

To comply with the accession-related obligations of Ukraine the Supreme Council of Ukraine adopted relevant amendments to the Laws of Ukraine "On Protection of Rights to Trademarks and Service Marks" and "On Protection of Rights to Goods Origin Designations" in April 2008. The amendments were aimed at harmonizing the national laws with the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS"); in particular, they balanced the co-existence of trademarks and geographical designations. Also in compliance with the obligation of TRIPS Article 63.2 Ukraine provides notifications of the laws, regulations, final judicial decisions and administrative rulings of general application, made effective and pertaining to the subject matter of TRIPS. The notifications are available at the WTO site.

The integration to the European Union is a more protracted way for Ukraine. However, the work on harmonization of the intellectual property legislation with the European legislation keeps its pace. The most recently introduced bill (2009) "On Certain Amendments to the Laws of Ukraine on Intellectual Property" includes numerous proposals on harmonization.

The proposals are aimed at the implementation of various European legislative instruments into the national legal framework. The European acts to be implemented are the Directive 98/44/EC of the European Parliament and of the Council of 6 July 1998 on the legal protection of biotechnological inventions, Directive 98/71/EC of the European Parliament and of the Council of 13 October 1998 on the legal protection of designs, Directive 89/104/EEC of the Council of 21 December 1988 to approximate the laws of the member states relating to trade marks, Council Regulation (EC) No 40/94 of 20 December 1993 on the Community trade mark, Council Regulation (EC) No 510/2006 of 20 March 2006 on the protection of geographical indications and designations of origin for agricultural products and foodstuffs.

Also aiming at the improvement and clarification of the national legal provisions the bill provides for implementation of certain rules of the international treaties: Paris Convention for the Protection of Industrial Property (1883), Madrid Agreement Concerning the International Registration of Marks (1891) and the Protocol thereto (1989), The Hague Agreement Concerning the International Deposit of Industrial Designs (1925), the Patent Cooperation Treaty (1970), and the Patent Law Treaty (2000).

Technology transfer in Ukraine – the level playing field for foreign investors

Until recently technology transfer activities were not included in a proper legislative framework. However, in 2006 the Law of Ukraine "On State Regulation of Activities in the Sphere of Technology Transfer" (the "Technology Transfer Law") was adopted. Subsequently, it was followed by the relevant government acts: Resolution of the Cabinet of Ministers of Ukraine "On Certain Issues of Technology Transfer" (2007) and Order of the Ministry of Education and Science

of Ukraine "On Procedure of State Registration of Technology Transfer Agreements and Administration of the State Register of Technology Transfer Agreements" (2008).

The Technology Transfer Law clarifies the main issues of technology transfer activities in Ukraine: subjects of technology transfer, framework of international cooperation of Ukraine, responsibilities of the state authorities, activities of technological brokers, etc. But the most important issues for foreign investors willing to engage in technology transfer into Ukraine are the mandatory requirements to the essential provisions of technology transfer agreements and prohibition of certain hardcore restrictions.

The provisions that are required to be included in technology transfer agreements are as follows:

- list of the technological components to be transferred;
- price of the technology;
- terms, place and means of technology transfer;
- conditions of technical knowledge and know-how transfer;
- licensing and sublicensing;
- territorial and field-of-use restrictions;
- insurance of technologies and their components;
- liabilities of the parties and certain other mandatory requirements.

The Technology Transfer Law also provides that the execution of technology transfer agreements with certain hardcore restrictions is not allowed. The prohibited restrictions are as follows:

- payments that considerably exceed the price of the technology and its components;
- obligations on the part of the transferee to buy raw materials, intermediate products, equipment and its components from the transferor when they are not applied during the manufacturing process;
- obligations on the part of the transferee to sell the products manufactured upon the technology so transferred preferably to the buyers determined by the transferor, or the use of the personnel pre-determined by the transferor;
- the right of the transferor to set the sales or re-export price of the products manufactured upon the technology so transferred;
- unjustified limitations on the volume of production and certain other practices.

Finally, it should be noted that due to the recent start of development of technology transfer legislation the technology transfer activities in the context of foreign investment are not overregulated, allowing for a broad discretion of foreign transferors with regard to the technologies they plan to import into Ukraine. ■

Mezzanine Finance - An Alternative Way of Financing Development of Companies

Jarosław Chałas is the Managing Partner at Chałas & Partners Law Office

The significant limitations on credit actions for banks reduces the possibility of acquiring the necessary capital to finance investment projects. In Poland the future development of companies now depends on acquiring funds for development from alternative sources.

One of these alternatives is mezzanine financing. Mezzanine in French means a half-floor, which describes the nature of this financing excellently. The rule is that this financing is mid-term in length and that it increases companies' funds by the capital necessary for future development for a specific period of time.

Mezzanine financing is a hybrid form of capital with features of both debt and equity. Debt means the financing of a company's development with a typical loan contract. The other method to ensure financing is the issue of bonds to increase share capital.

We can therefore state that a financing entity is not only interested in interests payment (debt component), but is also financially engaged (capital/equity component) and, as one of the owners, strongly motivated to ensure growth of the company. In other words, the financing entity acquires a double benefit, interest on the borrowed capital or purchased bonds and participation in generated profit and possible sales of stocks or shares to a future investor.

The company benefits from the engagement of a partner (financing entity) that intends the value of the company to grow. The cost is the interest payments and profit-share. When making a decision on mezzanine finance both parties must conclude an investment agreement that regulates the whole project comprehensively.

An agreement of this type is an unnamed contract in Polish law, and as a result its construction is based particularly on rules that concern the freedom of conclusion of a contract. Parties should specify in such an agreement:

1) what is a form of financing (debt component) - a loan or issuing bonds?

2) what is the interest rate of a debt (taking into account limits that result from anti-usurious regulations)?

3) what is the term of the debt and interest rate repayment schedule (taking into account that the most common method is repayment of an interest rate with the main sum paid at the end of the financing term)?

4) how is the performance of the agreement secured (taking into account the capital engagement of the financing entity it is not common to have assets of a company as a subject of a security), and what is more

5) what are the rules of resigning from an investment by correlating the term of a debt repayment with an interest rate and term of sale of shares or stocks possessed by a financing entity?

Taking into account the aforementioned investment risk for a financing entity, it should be stated that choice of a company that would be a party to the financing project of a mezzanine-type should be preceded by penetrating analysis of such issues as: financial results of a company, its potential for growth, cash flow, debt level, business plan and abilities of the management.

We should only hope that the search for alternative sources of finance for development is going to stay in the Polish market after the end of the financial crisis. ■

For further information please contact:

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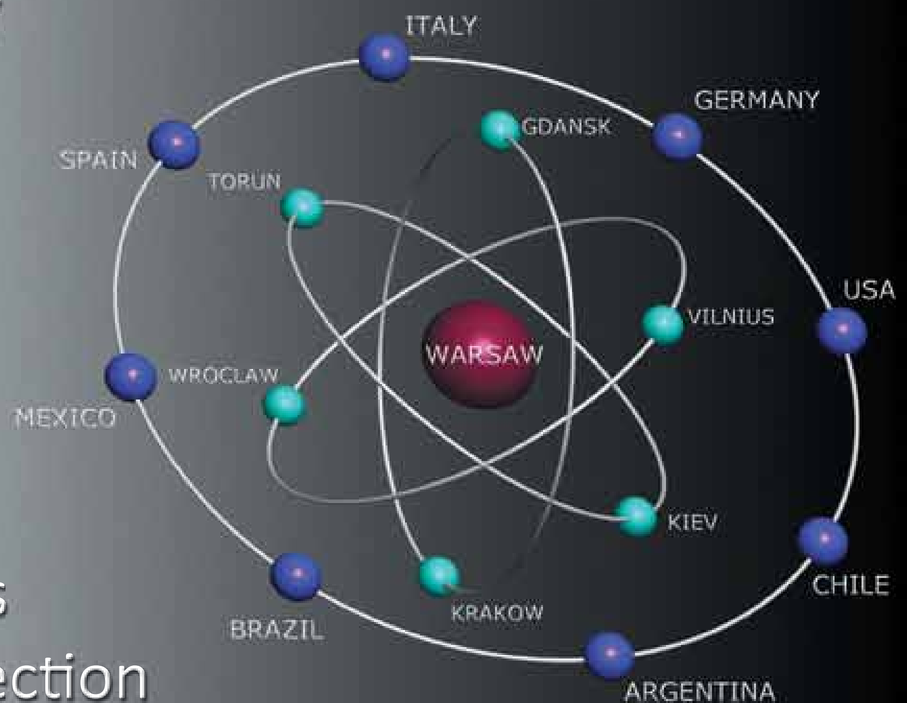

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Privatisation in Poland

Olga Zajączkowska-Drożdż is a Senior Associate at Kubas Kos Gaertner

The Polish Government intends to privatise 802 State Treasury companies from various economic sectors between 2008 and 2011. For this purpose, the Ministry of Treasury has prepared the *"Privatisation plan for the years 2008 – 2011"*, which was adopted by the Council of Ministers in April 2008 and further updated in early 2010. The privatisation plan also provides for the sale of 54 companies, viewed as strategic from the perspective of the Polish economy, that are to be privatised between 2009 and 2010, with 15 companies undergoing the process by the end of 2009 and 39 companies by the end of 2010.

The privatisation plan assumes the privatisation of State Treasury companies from various economic sectors, including the energy, chemical and plastics industry as well as chemical mines, financial institutions, hard bituminous coal mines, pharmaceutical, oil, iron and steel, defence, construction, engineering, transport, wood, food and other sectors.

The implementation of the privatisation plan required amendment of legal provisions, particularly the act of 30th August 1996 on commercialization and privatization (*Journal of Laws 2002*, No. 171, item 1397 as amend.) through the introduction of tools enabling the conduct of a more effective privatization policy, and in particular the abolition of restrictions on the sale of State Treasury shares through auctions (a possibility was introduced for the State Treasury to sell the shares of wholly state-owned companies as long as the reserve price is not lower than the share's book value – such possibility existed hitherto in cases of companies in which the State Treasury owned no more than 10% of the share capital), liberalization of provisions concerning analysis rules at the "pre-privatisation" stage (it is currently obligatory only to carry out an analysis of the company's legal situation as well as its valuation whereas the Minister of Treasury decides on the conduct of other analyses). The possibility to transfer Treasury-owned stocks or shares to local governments free of charge has also been expanded to include all companies in which the State Treasury holds shares. Also, the costs of privatization have been reduced and the duration of privatization processes has been shortened.

Pursuant to Article 1 of the Act of 30th August 1996 on commercialisation and privatisation (*Journal of Laws 2002*, No. 171, item 1397 as amend.) the commercialization and privatization of a state-owned enterprise consists in the complete transformation of a state or communal enterprise into a commercial law company. The act foresees two types of privatization, which could take the form of indirect or direct privatization.

Indirect privatisation consists in the sale of stocks or shares held by the State Treasury in companies with the reservation that commercialisation of the company must be carried out prior to the instigation of the privatisation process. This entails transformation of a state-owned enterprise into a sole-shareholder limited liability company or a sole-shareholder joint-stock company of the State Treasury. A company is formed as a result of commercialization in which the State Treasury takes up 100% of the stocks or shares until the completion of the privatization process during which the company is represented by the Minister of Treasury.

Statutory regulations ensure that the sale of such Treasury-owned stocks or shares occurs in public, whereas the provisions of the Act of 30th August 1996 on commercialisation and privatisation foresee the following modes of indirect privatization:

1) public announcement of offering

2) public tender

3) negotiations commenced on the basis of a public invitation

4) acceptance of a bid in response to a call announced on the basis of the act of 29th July 2005 on public offering and conditions on the introduction to trade of financial instruments and on public corporations (*Journal of Laws* No. 184, item 1539)

5) publically announced tender

6) sale of shares on the regulated market

A possibility has also been foreseen for the sale of shares belonging to the State Treasury by omission of the above-indicated modes if the buyer and the price are indicated in the privatisation agreement and the sale concerns the shares of companies in which the State Treasury possesses under 50% of the share capital, or the sale concerns the shares of companies in which the State Treasury possesses no more than 25% of the share capital.

In order to ensure that the sale of State Treasury stocks or shares takes place publicly, an offer on the sale of shares needs to be announced together with an invitation for the submission of bids in the tender, an invitation is made to take part in negotiations or in an auction in at least one national newspaper together as well as the *Public Information Bulletin* on the website of the Ministry of Treasury.

Direct privatisation is aimed at fast execution of the privatization process through sale, contribution of an enterprise to a company or its handover for use against a fee. The direct nature of privatization consists in the process being carried out with the omission of transformation of a state-owned enterprise into a sole-shareholder limited liability company or a sole-shareholder joint-stock company of the State Treasury. The provisions give rights to voivodes (provinces) to initiate the privatization process and carry it out upon obtainment of permission from the Minister of Treasury, after which they finalise privatization processes and conclude investor agreements. The following forms are distinguished under direct privatization:

1) sale of an enterprise

2) contribution of an enterprise to a company

3) fee-based handover of an enterprise for use

The Polish Ministry of Treasury conducts a policy of actively searching for investors. An internet service for investors has been set up for this purpose on the website of the Ministry of Treasury and an internet Centre of Investor Relations has been opened, thanks to which investors may obtain information on privatization processes. The privatization plan was also presented during the Economic Forum in Krynica, at a seminar held in Brussels (November 2008) and at meetings organized by the Ministry of Treasury in 2009 with representatives of Open Retirement Funds and Private Equity Funds.

Undoubtedly, the State Treasury's privatisation process is complex and requires time. Currently it is not helped either by the biggest global financial crisis since the Great Depression of 1929. Nonetheless, the Polish economy has not been as severely afflicted by it as other countries, including EU member states. Still, a noticeable side effect has been the uncertainty that has taken hold of financial institutions, which limit access to capital. Despite this, Poland was the only EU member state in 2009 that recorded positive GDP growth. Macro-

economic analyses show that Poland recorded a GDP increase of 1.7% in 2009 thus enabling the country to maintain positive economic growth. It is estimated that economic growth could reach over 3% of the GDP in 2010 and as high as 4.5% in 2011.[1]

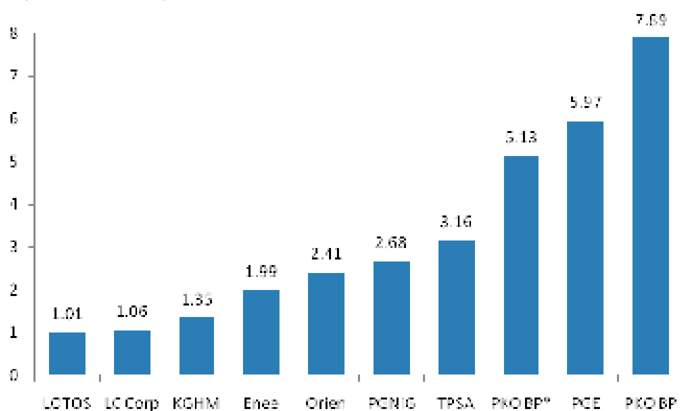
Analyses carried out by the Ministry of Treasury[2] reveal that revenues obtained from privatization in 2009 totalled PLN 6.97 billion gross – with the conclusion of 105 privatisation agreements, including 14 communalisation agreements. Revenues of PLN 11.53 billion were obtained from the sale of companies as part of public offerings on the stock market, whereas revenues from dividends paid to companies owned by the State Treasury amounted to PLN 7.84 billion. As such, the Ministry of Treasury received PLN 26.34 million in cash flow in 2009.

The estimated economic growth in 2010 – 2011 should positively impact on increased capitalisation of companies put up for sale, owing to a rise in stock market indices as well as the expected improvement of companies' economic performance, which will additionally contribute to increased income from privatizations.

It ensues from the above data that despite the lack of stabilisation on markets and due to economic slow-down around the world, Poland's economic policy in the area of privatisation appears just. On the other hand, disclosure to the market of the management rules of privatized companies that will no longer be under the protective umbrella of state influence could also act as a positive stimulus.

Analyses carried out by the Ministry of Treasury confirm the positive reaction of investors to such a stance of the Polish government on public finances and privatization issues. This is indicated by the high-price debuts of privatized companies on the Warsaw Stock Exchange. For example, the "Bogdanka" Lubelski Węgiel coal mine debuted on the stock exchange on 25th June 2009 reaching PLN 528 million.

The largest issues in the history of the Warsaw Stock Exchange (in PLN billion)



** issues in 2009*
Source: http://www.money.pl/gielda/wiadomosci/artykul/gpw;pge;zyskuje;13;proc;na;debiucie,202,0,554698.html

Historic issues of shares on the Warsaw Stock Exchange clearly confirm the effectiveness of the privatization process conducted through the Warsaw Stock Exchange. This is also the path chosen by the Ministry of Treasury for a few "pearls" of Polish economy, such as PZU (which has now concluded its dispute with Eureko) and the Warsaw Stock Exchange. Both companies are expected to make spectacular debuts on a European scale.

Pursuant to the determinations of the Council of Ministers of 7th July 2009, the Minister of Treasury was obliged to speed up the conducted privatization processes. 2010 is to be a breakthrough year due to the high forecasted revenue from privatizations. It is estimated that the planned revenues from privatization will reach approx. PLN 25 billion in 2010.

In relation to the privatisation strategy being carried out by the Polish government, the Parliament of the Republic of Poland passed an act on 12th February 2010 on special powers for the Minister of Treasury and their execution in certain capital companies or capital groups conducting operations in the electricity, oil and gas fuels sectors, that shall come into force on 1st April 2010. The act, which concerns a so-called "golden veto", namely special State Treasury authorizations in companies of strategic significance for Poland, gives the Minister of Treasury special powers in capital companies or capital groups conducting operations in the electricity, oil and gas fuels sectors whose assets have been disclosed on the uniform list of buildings, installations, devices and services part of critical infrastructure mentioned in Article 5b indent 7 point 1 of the Act of 26th April 2007 on emergency management (*Journal of Laws* No. 89, item 590 as amend).

Pursuant to Article 2 of the Act, the Minister of Treasury may object to a resolution adopted by a company's management or another of its legal actions whose object is the disposal of assets part of critical infrastructure and which threatens the functioning, continuity of operations or integrity of the infrastructure.

The Minister of Treasury also has the right to object to a company board's resolution on the company's dissolution, change of purpose or discontinuation of use of one of its assets, change of the company objective, sale or lease of the company or an organized part thereof or the establishment of a limited right in property thereon, adoption of a material and financial plan, investment plan, long-term strategy plan or transfer of the company seat abroad. An objection may be raised only if the implementation of the resolution were to constitute a real threat to the functioning, continuity or integrity of the critical infrastructure.

Objections must be expressed in the form of an administrative decision and are subject to administrative appeals. It is also possible to pursue claims for compensation due to material losses suffered by companies – on the basis of the provisions of the act of 22nd November 2002 on compensation of material losses resultant from the limitation of freedom plus human and civil rights during the time of a state of emergency (*Journal of Laws* No. 233, item 1955) – as a result of issuance by the Minister of Treasury of decisions conformant with the law (hence decisions on the expression of an objection).

In the event of issuance of a decision violating the law, a possibility exists to pursue compensation claims through civil-law means (on the grounds of the act of 23rd April 1964, the Civil Code) on the basis of provisions on the liability of the State Treasury for damages.

The Act enters into force on 1st April 2010 and is the effect of determinations made with the European Commission and the expression of acceptance of the stance of the Court of Justice on the scope of a state's interference in the economic activity and decisions made in capital companies and groups, with consideration of the principle of free movement of capital. Therefore, the possibility for the State Treasury to lodge a so-called "golden veto" has been limited to situations in which the exercise of resolutions in capital companies or groups operating in electricity, oil and gas fuels sectors would constitute a real threat for the functioning and continuity of the operations of such entities. ■

For further information please contact:

Tel: +48 (12) 619 4040
www.kkg.pl

1. *Miesięczny Przegląd Makroekonomiczny BreBank, February2010 r.*
2. *Website of the Ministry of Treasury www.ms.gov.pl*

Investing In Portugal: A Matter of Realistic Optimism

Abel Sequeira Ferreira is a Partner at Raposo Bernardo

In a time of global post-downturn, the big question for Portugal is whether the country is still capable of attracting the investment essential to its own recovery and growth. All factors considered, the answer is 'yes'.

All around the world, there are signs of economic recovery finally entering a healthy and steady rhythm. But, at least in Europe, there are also many reasons for great concern: big public deficits, raising employment rates, consumer pessimism, and, more recently, the Greek crisis.

There is growing uncertainty regarding the situation of Greek public finances and how to solve such a major financial trouble, and that growing feeling of uncertainty has also contributed to raise doubts about the financial health of other euro-zone member states. Spain, for example, has been often referred as being in an imminent risk situation. But Portugal, also, is an equal target of some concerned remarks concerning its economical situation.

Thus, now that the series of bubbles that kept the world economy going on for the last decades have burst and a hard post-downturn is on the horizon, the big question for Portugal will be if the country still has the capacity to attract the good investment essential to its own recovery and future growth.

With a unique location, in the West Coast of Europe, Portugal is a well-known fully-integrated member of the European Union and the euro-zone, with an open market-based economy and a market of approximately 10.6 million people (to whom the more than 4 million Portuguese, and their descendents, living abroad and settled mainly in France, Germany, Switzerland, Luxembourg, US, Canada, Venezuela and Brazil, must be added).

But, when looking at the Portuguese market, one must take into consideration that Portuguese is the 5th most widely spoken language in the world, therefore making it potentially much larger than its 10.6 million inhabitants. More than 200 million people speak Portuguese worldwide, including countries like Brazil, Angola, Mozambique or Cape Verde, but also Macau, as Portugal has privileged relations with Portuguese speaking countries throughout Africa, Asia, and South America.

This also makes Portugal an excellent entry point to companies looking for access to such other markets, which they can do through Portugal; and, simultaneously, Portugal is an equally excellent entry point to outside companies trying their chance in the broader European Union market.

Economically and politically stable, Portugal has been running a consistent privatization program for more than ten years now (with privatization of more than one hundred previously state-owned companies).

The Portuguese capital market got excellent reviews from the last IMF *Financial Stability Report* and it is important to remember that the Portuguese stock exchange, Euronext Lisbon, is a part of group NYSE Euronext, thus, providing issuer companies with a complete portfolio of financing mechanisms, bigger visibility, notoriety and credibility, wider shareholder base (divided by investment profile and nationalities), larger international exposure and easier access to other European markets.

Lastly, English and other foreign languages like French are widely spoken and the country has excellent physical and IT Infrastructure which, in part, explains why, recently, a growing number of multinational technological companies are choosing Portugal to install high level high touch international business, know-how and support centres.

This said, of course, one cannot ignore the recent unprecedented global recession and its implications regarding the Portuguese economy.

As the country's economy is completely integrated, the global turmoil had to have an impact on the Portuguese financial system. The main result was a slowdown in banking activity and an indispensable revision of banks' asset and liabilities management strategies. The good news, afterwards, is that the country's banking system showed significant resilience in the face of unprecedented crisis, managing to keep their financial intermediation activity on track.

Changes in the regulatory framework of the euro-system monetary policy, state guarantees made available at the right time (namely, with the government guaranteeing debt issued by the banks) and the adoption of more competitive strategies to build customer deposits, have also helped to navigate the worst of the storm.

Customer deposits grew strongly (up 12 per cent in December 2008) and the banks also managed to issue a considerable volume of debt, around 17 thousand million euros in bonds; an expected rise in default ratios of the non-financial private sector looks is not likely to jeopardise financial stability.

The conclusion is that against a global backdrop of extreme uncertainty, the Portuguese financial system coped extremely well with the situation (especially, when compared to other member states' systems), avoiding a downward spiral and still helping to the slow recovery of the real economy.

Of course, restructuring the economy, in order to fight the excessive debt burden and address the budget deficit, will be a difficult task, but there are reasons for some realistic optimism; indeed, before the crisis, the Portuguese situation was improving: the economy grew by 1.2% in 2006, 1.8% in 2007, and around 0.3% in 2008 - at the same time the budget deficit went down from a high of 6% in 2005 to 2.6% in 2007; the deficit for 2008 was 2.7%.

According to the Portuguese Central Bank, Gross Domestic Product is expected to increase by 0.7 per cent in 2010 and 1.4 per cent in 2011, after contracting by 2.7 per cent in 2009.

It is true that budget tightening will probably limit the rate of economic growth; however, on the other hand, negative growth, unemployment rises and greater public spending cannot serve as excuse to avoid implementing further public sector reforms or to postpone, at least for long, a number of large scale investments already approved.

The new international airport, the high-speed train link to Spain, the continuous investment into renewable energy parks, and new infrastructure like ports, hospitals and, maybe less likely in the near future, new highways, deserve a closer look among the public and private projects announced and/or being developed, as they will create new opportunities for providers from different sectors and business activities.

At the same time it is expected that the country keeps focusing on

investment in certain economic niche sectors like tourism, high quality industrial components or technology services.

Meanwhile, there is another aspect worth getting our attention.

"... a growing number of multinational technological companies are choosing Portugal"

In fact, as recent literature shows, investors (namely, institutional investors) seek to invest into firms with good governance indicators, and even if certain country-level factors, like the political and economical stability that was just referred, are relevant, the more significant aspects of investment attraction are related to firm-level characteristics (meaning that even a "good firm" in a "bad" country, which is not Portugal's case, can still attract good investment, in reality, regardless of that country economic growth pattern).

Simultaneously, the presence of legal and regulatory protections for investors explains up to 73% of the decision to invest (company characteristics explain only around 20%, at best). Therefore, it is important to address the country characteristics influencing the firm-level governance factors. Transparency, accountability and a sound regulatory environment are the key words.

And, anticipating the analysis below, it seems clear that Portugal is also at standard on the economic, legal, and political indicators included in the main assessment by investors when making investment oriented decisions.

Starting with corporate governance, Portugal is, currently, in an excellent position amongst other EU member states. The basis for the corporate governance system in Portugal is the Commercial Companies Act which establishes its basic framework. Updated as recently as 2006, the Act is complemented with a set of "Recommendations on Corporate Governance" by CMVM, the securities market regulator, which are subject to regular revision, amendment and updating (one of such is currently ongoing).

The CMVM recommendations contain rules of conduct to be observed in the direction and control of listed companies covering areas such as disclosure of information, exercise of voting and representation rights of shareholders, corporate rules, board of directors role and institutional investors.

Following the 2006 revision, the Commercial Companies Act now includes three different governance models and contains provisions that address, in line with international best practices, other issues like independence and competency requirement for audit and oversight bodies, requirements for independent members, minority rights, and investor protection.

The European Union Takeover Directive and the Directive on transparency requirements were also transposed into Portuguese law and the Portuguese Securities Code updated accordingly.

The World Bank's *2010 Doing Business* report notes that Portugal has been strengthening investor protections and that investor protection in Portugal is slightly higher than the average achieved by member states of the OECD, meaning that Portugal ranks above average in what regards disclosure, liability of directors and powers of shareholders to challenge transactions.

In the same report, Portugal still ranks badly regarding its labour system; the report looks at the system of laws and institutions created by the country with the intention to protect workers and guarantee a minimum standard of living for its population, paying attention to employment, industrial relations, social security and occupational health and safety laws, and measuring flexibility in the regulation of hiring, working hours and dismissal in a manner consistent with the conventions of the International Labour Organization.

Based on the two measures that are presented, a rigidity of employment index and a redundancy cost measure, the report finds that, although slightly improvements were made in recent years, Portugal's labour system is still too rigid and too costly when compared with similar European economies.

Portugal does a little better regarding its tax system. Companies doing business in Portugal have to deal with Corporate Income Tax (IRC), that taxes corporate persons having their head-office or effective management in the Portuguese territory, which are considered to be resident, and, in certain situations, unincorporated entities having their head-office or effective management in the Portuguese territory (deemed to be resident) and incorporated or unincorporated entities without their head-office or effective management in the Portuguese territory (deemed to be non-resident), namely, when deriving income therein not liable to personal income tax (IRS).

Also very relevant are the Personal Income Tax (IRS), levied on the yearly amount of incomes comprised in the categories enumerated in the IRS Code, after the appropriate deductions and allowances, which adopts a very broad notion of income from dependent employment, and the Value Added Tax (VAT), the general tax on consumption, knowing that Portugal still has one of the highest Value Added Tax (VAT) rates in Europe.

Municipal tax on real estate transfer (IMT), levied on the transfer for consideration of ownership rights or parts thereof on real estate (immovable property) situated in the Portuguese territory, municipal tax on real property (IMI), levied on the taxable net-worth value of real property classified as rural or urban property situated within the Portuguese territory, and stamp duty, levied on any deeds, contracts, documents, securities, books, papers, and other events comprised in the General Schedule attached to the Stamp Duty Code, can also apply in its respective and specific situations.

According to the World Bank's *2010 Doing Business* report above referred, for 2010, the total tax rate, as a percentage of profit, is 42.9%, a slight improvement when compared with 44.8% in 2008.

In what regards the judicial system, often considered too slow and inefficient, Portugal was also able to introduce some reforms, for instance, reducing the time and improving the procedures for contract enforcement by enabling e-filing for the initiation of a suit and by lessening the need for a judge's intervention in the execution of judgment.

Overall, and even if there is a lot of work to do and plenty of reforms to be implemented, Portugal compares very well to the current "real economy" situation of its member states neighbours, providing investors and companies with specific advantages that can be better used if working with the right local partner who can provide advice and help, namely, referring to the appropriate legislation or to other texts of a more specific scope. ■

For further information please contact:

Abel Sequeira Ferreira email: asferreira@raposobernardo.com
Tel: +351 21 312 1330

Company Formation in Bermuda

Bermuda offers international companies two sets of advantages. The first are available in some other jurisdictions. The second are specific to Bermuda and, often, to individual industries operating from the island.

Alone among the many offshore jurisdictions, Bermuda's business community is large enough to handle enormous and complex international transactions, but small enough to understand the need to maintain the Island's reputation for probity. In some ways an exclusive club, Bermuda deals only with those whose bona fides are beyond reproach.

Those who do business on the island do so in the knowledge that Bermuda has been accepted by the OECD, the International Monetary Fund and a host of other international bodies as having transparency and standards that match those of other major developed countries.

Why form a Bermuda company?

In short, Bermuda companies are Best in Class. The advantages of a Bermuda element in the international corporate architecture may be considerable. The island is home to several thousand investment holding companies; 1,500 insurance and reinsurance companies; funds of many types; and a corps of independent fund administrators. Hundreds of ships and airplanes are registered in Bermuda. The Bermuda companies cross industry types and geographical origins. Companies from around the world and their financial instruments are quoted on the Bermuda Stock Exchange.

All these companies have found a use for Bermuda in their international activities. Many other investors own Bermuda companies for reasons particular to their circumstances or status.

Among the advantages Bermuda offers are its economic and social stability; e-commerce friendliness; a lack of exchange controls; daily flights to and from the Eastern Seaboard and Europe; investment flexibility; progressive legislation; location; a public/private partnership that encourages good business; quality support services and business infrastructure; tax neutrality, ie. no corporation tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance taxes; state-of the art telecommunications with sophisticated back-up and disaster recovery capabilities; a convenient time zone between Europe, Africa and the Americas; and a sophisticated workforce.

For information on Bermuda, a good starting point is the Government's website: www.gov.bm.

How to form a Bermuda company

Before starting the process of forming a Bermuda company, the advice of legal, tax and other professional advisors should be sought. Ownership of a Bermuda company will almost certainly have ramifications beyond Bermuda.

The path to forming a Bermuda company usually goes through a local service provider, who is familiar with the process. Overseas professionals often recommend a suitable Bermuda firm, which may be part of a legal or accounting practice, a professional corporate management firm, or part of a bank or another business.

Bermuda law is not onerous, but is specific and it changes regularly to take account of circumstances. A local manager will be au fait with all these details and will often act for the new company after it has been formed, providing directors and officers, meeting ongoing Bermuda requirements, making company filings, maintaining the company's records and so forth.

Passing muster

Two main elements must be satisfied before a company formation may proceed.

First, the source of the capital needed to run the business will be carefully scrutinised. Its provenance must be flawless, or the application will fail. Proposed borrowing must make sense in context, and its likely sources should be included in the application.

And second, the background, reputation and experience of the individuals who will manage the enterprise will be closely investigated during the application process. Each sponsor should have a solid track record in business and in his or her private life; both aspects will be looked at in detail.

It is always a good idea to present a well thought-through business plan, which answers all the obvious questions about the proposed venture in a clear and concise manner, accompanied by the necessary documentation. The plan should make a compelling case for the viability of the proposed venture, based on reasonable assumptions and forecasts, which may be questioned by the Registrar of Companies as the application is processed.

Before the company is formed

The use of shelf companies is not practised in Bermuda; new companies are incorporated. For that to happen a series of steps must be followed and tests passed. The first two are:

Bermuda Monetary Authority (BMA) approval for setting up the company. All proposed owners of five percent or more of the company's share capital must submit certified copies of their passports and make statements as to their personal history. The same applies to the ultimate beneficial owner, whose name must be disclosed. The BMA carries out extensive vetting of proposed owners. Then comes company name approval. Proposed names, which may be reserved at the Registrar of Companies, must meet certain guidelines, may not clash with existing names, and must not contain a small number of specific words and terms.

Choice of vehicle

Broadly, companies may be formed in Bermuda to business locally, or to do business outside Bermuda from the island. The latter is called a Bermuda exempted company; it is exempted from a rule that requires local companies to be majority Bermudian-owned.

Bermuda companies fall into four categories: those whose liability is limited by shares or by guarantee; those with unlimited liability; and companies of a limited duration.

The vehicle most used by those starting their Bermuda connection is the exempted limited liability company.

What rules apply?

The company's Memorandum of Association (MofA) and the bye-laws set the purposes of the company and the rules by which it will operate, subject to relevant laws. A copy of the MofA will be held by the Registrar of Companies and is available for public perusal, as is the company's Register of Charges, which logs any indebtedness, loans or other charges or commitments the company may be carrying.

- Registered office
  Bermuda companies must have a registered address, where the company's share register and other records are kept. It may not be a post box.

- Shareholders, directors and officers
  A Bermuda company must have at least one shareholder, who may be a nominee. Bearer shares are not permitted. Bermuda exempted companies must have directors, a company secretary and a resident representative, at least one of whom must live in Bermuda. The company must maintain a register of shareholders, directors and officers, which is available for public scrutiny.

- Financial records
  Company records may be maintained anywhere, but sufficient

SECTOR FOCUS: E-COMMERCE

Bermuda has three marine cable systems (composed of five marine cables) coming into and then out of Bermuda. These systems are separately owned. All three provide a quite staggering amount of capacity and a significant element of redundancy, thus securing Bermuda's links with the outside world.

Since being among the first countries in the world to pass legislation specific to e-commerce more than a decade ago, Bermuda has kept a steady focus on electronic possibilities in the public and private sectors, both internally and externally.

From a business perspective, in Bermuda, e-commerce does not mean giant server farms or warehouses stocked with goods to be bought online. Like all its business activities, Bermuda's e-business is about brains. Its developing pool of intellectual capital is proving to be a smart place for outsourcing solutions.

A strong technology support network is in place with online publishers, web designers, software and hardware vendors and ISPs. Top quality hosting facilities are available, with maximum security and full redundancy, as well as the spectrum of telecommunications options.

For a number of years, Bermuda has placed among the top tier in the world in the e-readiness rankings prepared by the Economist Intelligence Unit in co-operation with the IBM Institute for Business Value, ahead of Japan, France and a host of other countries.

E-readiness is the "state of play" of a country's information and communications technology infrastructure and the ability of its consumers, businesses and governments to use such technology to their benefit. When a country does more online — and, as is increasingly the case, wirelessly — the premise is that its economy can become more transparent and efficient.

Bermuda has for more than a decade imposed strict limitations on the material that may be hosted from the island. Gaming and pornography have always been banned. Anti-child pornography and Internet luring legislation has been enacted, with all-party support.

The drive to bring government fully online continues apace, with several Ministries now offering a complete range of services online. Steps have been taken to automate the vehicle registration process and to electronically identify offenders. The island's Tech Innovation Awards have gone from strength to strength.

Because of the island's remote location, telecommunications has been the lifeline for more than a century. The Government's consistent focus on e-commerce and its possibilities keeps the world's leading financial services jurisdiction at the forefront of the march of electronic commerce. Opportunities exist within the sector for companies with good ideas and financial discipline.

data must be kept in Bermuda to allow directors to assess the company's financial condition. Many companies simply keep their Bermuda records at the registered office.

- Operational mechanics
  A Bermuda company must choose a financial year-end and outside auditors. It may use a company seal and open bank accounts in Bermuda or elsewhere.

Approval

Once the BMA approves the incorporation of the company a certificate of incorporation is issued. Organisational meetings are then held. The provisional directors, who incorporated the company, usually approve the company's bye-laws, allot the shares and call a statutory general meeting of shareholders. They, in turn, appoint the company's full-time directors and officers, appoint auditors and adopt the bye-laws of the company.

A first meeting of the directors usually follows. The new board of directors establishes the company's registered office, makes appointments as the law demands for a secretary and registered representative, opens bank accounts and generally gets the company under way.

The banking system

Bermuda's four licensed banks are more widely international in scope than most of their British or North American counterparts. A range of currencies is available from banks on short notice, and multi-currency transactions are an everyday part of normal business activities.

The banks serve different market segments. Bank of Bermuda is a subsidiary of the international HSBC bank. Butterfield Bank fulfils the functions of a super-regional bank, with subsidiary and affiliated operations in 15 countries around the world. Bermuda Commercial Bank handles only international business transactions. Capital G is a community bank and high-level financial advisor.

Costs

Fees are charged for incorporating an exempted Bermuda company, which must have a minimum share capital of $12,000 or its equivalent in other currencies. Annual fees apply after incorporation. If the company does not intend to maintain a physical presence in Bermuda,

it is necessary to appoint a local manager to ensure that the company is kept current with Bermuda law. The manager may provide directors, hold meetings and provide other services, for which fees are charged.

Those who work in Bermuda are charged a relatively small payroll tax (16 percent, employer and employee combined) and must make social security and pension contributions, which are tightly regulated.

Speed to market

Applications need not take much time, if all the requested information is provided, is accurate, and meets the Registrar of Companies' exacting standards.

Small, private companies can be up and running in a matter of a week or a few weeks, depending on the complexity of the application. Bermuda prides itself on its speed to market.

Regulation

All commercial activity in Bermuda is regulated by the Bermuda Monetary Authority (BMA), an independent body. Its Board of Directors is appointed by the Ministry of Finance, but the BMA otherwise stands alone.

The Authority regulates the island's corporate interests by a set of rules that meet, or exceed, international standards. It is no easier to run a bank or a hedge fund from Bermuda than it is anywhere else in the world. What Bermuda offers is less unnecessary red tape, without compromising the purpose of, and pressing need for, oversight, monitoring and regulation.

The BMA recognises, as do its counterparts elsewhere with increasing regularity, that different companies and enterprises present different regulatory challenges. The BMA's mission is to regulate and monitor the financial sector's business activities for the good of various constituencies: the global economic system; Bermuda itself; shareholders in, customers of, and suppliers to companies registered in Bermuda; and others who deal with the Bermuda companies. ■

Brazil vs. United States - Cross Retaliations a Possible Alternative

José Setti Diaz and Cinthia Battilani, Partners, Fernando Benjamin Bueno, Associate, and Lucas Queiroz Pires, Trainee, are in the International Trade Department, Demarest e Almeida Advogados, São Paulo, Brazil

Introduction

Brazil has already set its legal and trade foundations to implement Brazil's retaliation rights against the United States of America (US), authorized by the World Trade Organization (WTO) at the end of 2009, within the cotton dispute[1].

The Brazilian Ministry of Development, Industry and Foreign Trade (MDIC) published for public consultation a list containing a large number of products originating from the US that could be subject to a surcharge on import duty rates. In February, a law was enacted by the President authorizing cross-retaliation in intellectual property rights (IPR's) and services sector against countries that had not complied with WTO obligations.

Such measures not only represent a great progress on the discussion about possible retaliations to be applied on the dispute between Brazil and US, but also for the future of the multilateral system, since it could be the first cross-retaliation effectively adopted in international trade recent history.

Background of the upland cotton dispute

The dispute between Brazil and US was initiated in September 2002, when Brazil filed a complaint to the WTO against the concession of subsidies by the US government to American cotton producers. According to the Ministry of Foreign Affairs of Brazil, US agricultural policies had caused distortions with adverse effects to international cotton prices, by means that the measures would artificially stimulate

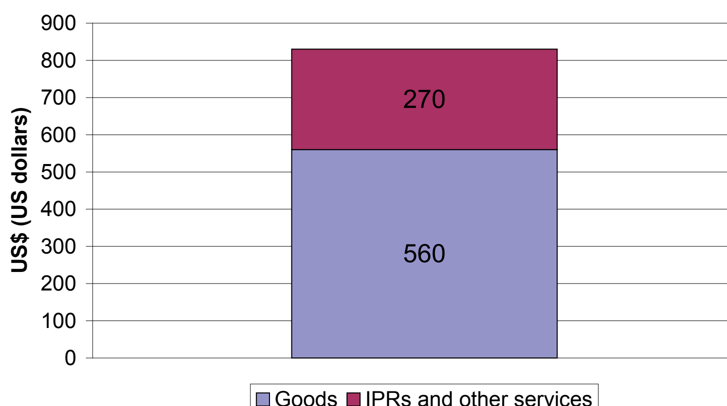
the development of US production. For this reason, Brazilian cotton producers declared they suffered damage to their income.

Brazil has challenged several US domestic support and export subsidies/credits programs. Argentina, Australia, Benin, Canada, Chad, China, Chinese Taipei, the European Union, India, New Zealand, Pakistan, Paraguay and Venezuela also participated in the dispute notifying their interests as third parties.

Three years later, the Appellate Body found that US measures were inconsistent with the Agreement on Subsidies and Countervailing Measures and with the Agreement of Agriculture, recommending that the US brought its measures into conformity and withdrew the prohibited subsidies without delay. However, in view of the maintenance of the subsidies by the US government, Brazil's appropriate countermeasures was then discussed, the possibility of retaliation, and how it could be applied against the US.

At the end of 2009 a WTO decision determined that Brazil should be allowed to impose retaliatory measures. Brazil announced that they could retaliate to US$830 million worth of trade with the US (see the diagram below).

Figure 1. Brazil's Retaliation Rights Distribution Against the US



Out of the total amount of US$830 million that Brazil could sanction, US$560 million would be within the group of goods traded between Brazil and US. The remaining US$270 million would be applied in a different sector, by suspending certain obligations under the Agreement o Trade-Related Aspects of Intellectual Property Rights (TRIPS) and/or the General Agreement on Trade in Services (GATS), targeting services as well IPR's[2].

Cross-retaliation as the last alternative to implement a WTO decision

According to WTO rules, if the respondent fails to implement the recommendation and ruling of the Dispute Settlement Body (DSB) within a reasonable period of time, which is agreed between parties or through an arbitration procedure, parties will try to set a mutually acceptable compensation. It should be noted that compensation is voluntary. If no satisfactory compensation is agreed, the complaining party may seek an authorization from the DSB to suspend the

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application of concessions or other obligations to the respondent, as follows:

(i) Complaining party should first seek, as a general principle, to suspend concessions or other obligations with respect to the same sector, in the present case, the cotton sector.

(ii) If the complaining party considers that the last is not practicable or effective, it should seek to suspend concessions or obligations in other sectors which are ruled by the same WTO agreement that ruled the cotton sector (Agreement on Agriculture).

(iii) As the last alternative, the complaining party may suspend concessions or other obligations under another WTO agreement. This option is known as a cross-retaliation.

"... stakeholders in this discussion have to rush to influence the steps that are forthcoming, especially those trying to avoid the cross-retaliation route"

Therefore, cross-retaliation occurs when a country retaliates in a different sector and also concerning a different WTO agreement that had not been violated by the respondent in a specific dispute. Thus, the possible Brazilian suspension and limitation of IPR's (regulated by the TRIPS), derived from the cotton dispute (regulated by the Agreement on Agriculture), could be an example of cross-retaliation.

Under the WTO framework, cross-retaliation in goods has been authorized twice before. First, on the dispute between Ecuador and the European Union, involving bananas, and second, on the dispute between Antigua and Barbuda against the US. However, those retaliations were never implemented by the complaining countries.

One of the main reasons for not retaliating is that developed WTO members who are respondents are not likely to be harmed by the suspension of concessions in goods or services, when executed by a developing or least-developed one. It may be observed that the trade impact that arises from a dispute between a developed country and a developing or least-developed country shall not be significant to compel the developed country to comply with a decision, as consequence of an unbalanced nature of trade relations and the differences in economic status. On the other hand, the developing country may be harmed since consequences could be brought to its own consumers through increased prices or even decrease in supply of products or services. That may not be necessarily the case, but developing countries like Brazil, China and India have powerful economies and consequently may have material impact in developed countries if they decide to impose restrictions on market access (ie. goods).

Suspension of concessions on intellectual property rights could be a valuable tool to induce compliance by developed countries, since by restricting or suspending these rights, a country may cause economic damage regardless its level of development to a developed country, without making its consumers suffer from higher prices.

Brazilian cross-retaliation law focuses on Intellectual Property Rights

On February 11th, the *Brazilian Official Gazette* published a provisional measure, approved by President Lula, regarding the limitation or suspension of IPR's against one country who failed to comply with obligations imposed by the WTO. Surely, such measure represents an improvement in the discussion related to the sort of retaliation Brazil could apply against the US.

The recently approved legislation enabling cross-retaliation comprised several measures: (i) suspension and limitation of IPR's, (ii) modification of rules and procedures that assure IPR's protection, (iii) temporary prohibition of royalty remittances, (iv) surtax application to remuneration of IP owners.

Among the ways to apply those measures, the law sets forth alternatives such as: (i) by postponing or subtracting the protection periods of IPR's, (ii) by licensing or by establishing non-commercial public use, without the title holder's authorization, (iii) by suspending the exclusive right of the titleholder to block the commercialization of goods that encompass patent rights, (iv) by increasing the values owed to organizations or entities of the Public Administration for IPR's registration, to obtain it or in its maintenance; and (v) by creating new obligations of registration to obtain and maintain IPR's.

Many sectors could be affected by the application of such measures in the IPR field, in opposition to what was being speculated over the suspension of IPR's only to the pharmaceutical sector.

Retaliation in goods

Brazil, as one of the main developing countries in international trade, obviously different than Ecuador and Antigua and Barbuda, may have some leverage to harm at least a part the US economy in case of the imposition of retaliation in goods. For those reasons, recently, the Brazilian Foreign Trade Chamber (CAMEX) has been taking actions to promote retaliation against the US.

The Brazilian government has submitted to public consultation a preliminary list of tariff codes that could be subject to the retaliation measure, stating that several US products should receive a surcharge up to 100 percentage points on import duty rates. CAMEX held a meeting concluding that a final list containing US products that would be subject to retaliation will be published on the 8th of March.

If Brazil follows all steps to implement the WTO decision in the upland cotton case, at first the retaliation would be in goods up to the limit of U$560 million in this field. Subsequently, if retaliation reaches this threshold, Brazil would trigger the cross-retaliation for the remaining US$270 million in the IPR's and/or services sector.

What's next?

Brazil's legal and trade framework is prepared for retaliations in goods and in the IPR sector, but there are rumours of negotiations between Brazil and US which can raise up some sort of an agreement, specially with recent declarations from governments and the private sector to avoid the cross-retaliation route. In any case, stakeholders in this discussion have to rush to influence the steps that are forthcoming, especially those trying to avoid the cross-retaliation route. ■

1. *WTO - United States - Subsidies on Upland Cotton - DS267*
2. *WT/DS267/41*

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