The Florida Bar Website: ***www.floridabar.org***
International Law Section Website: ***www.internationallawsection.org***

INTERNATIONAL LAW QUARTERLY

Volume XXI, No. 1 **THE FLORIDA BAR** **Summer 2005**

INSIDE:

Reserve the Date:

International Income Tax and Estate Planning (0368R)

Hyatt Regency Miami, October 14, 2005

April Symposium Draws Participants From Many Countries

On April 23-26, 2005, the International Investment Symposium (organized by the International Law Section) gathered over 200 participants from many countries, including Canada, Ukraine, France, Italy, Spain, Germany, Switzerland, Mexico and Russia.

Attendees included lawyers, bankers, businessmen, decision-makers, accountants and other professionals. Over several days, meetings, lectures and workshops focused on topics such as international real estate, mortgages, private equities and natural resources (e.g., oil, gas, gold). These continuing legal education courses analyzed current investment laws, treaties and practices involving Europe, North America and Russia.

On Saturday, April 23rd, the Symposium kicked off with a champagne reception aboard the yacht "Miami Magic" which toured historic Biscayne Bay, allowing attendees to mingle, network, and enjoy Florida's beautiful weather, waters, and landscape.

The following day, an International Notary Forum was held (attended by about 50 civil law notaries from North America, Europe and Russia), which addressed issues involving

See "Symposium," page 3

Florida Supreme Court Addresses Necessity of Prejudice for Waiver of Right to Arbitrate

By Alvin F. Lindsay and Richard C. Lorenzo

On February 25, 2005, the Florida Supreme Court issued *Raymond James Fin. Servs. v. Saldukas*, 30 Fla. L. Weekly S115 (Fla. 2005), where it resolved a certified conflict from the Second District of Court of Appeal as to whether a party must suffer prejudice in order for an opposing party to be deemed to have waived its right to arbitrate.

Previously, there had been a split on the issue between the Third and First districts on the one hand, and the Second, Fourth and Fifth Districts on the other. In *Lane v.*

See "Supreme Court," page 23

Chair's Report 2004 – 2005

This year we focused on improving our internal functioning and organization as well as expanding our international outreach programs. The Chair's objectives included primarily to establish solid and efficacious foundations for the continued movement of our Section towards world wide dynamism.

We commenced our year with two special retreats, in Miami and Gainesville, which were fountainheads of new ideas, committees, and actions. The input received resulted in improving our organization as follows:

1. stimulating the Executive Committee (composed of the Chair, Chair-Elect, Secretary, Treasurer and Immediate Past Chair) to meet monthly, with clear agendas, in order to effectuate actions and decisions; these meetings have in fact resulted in extremely positive and concrete steps being taken, especially since our Coordinator (Angela Froelich) also participated efficiently and rapidly;
2. clarifying and improving our other Committee structures and staffing them with dynamic "new blood" (all the while conserving experienced volunteers).

Our current standing committees consist of the following:

- Certification– *Chair: Andrew J. Markus*
- Continuing Legal Education – *Chair: John H. Rooney*
- Customs & Trade Law – *Chair: Peter A. Quinter*
- European – *Chair: Ambler H. Moss*
- Faculty Council – *Chair: Janet Stearns*
- Free Trade Area of the Americas – *Chair: John H. Rooney*
- Improvements – *Chair: John H. Rooney*
- Immigration & Nationalization – *Chair: Larry S. Rifkin*
- Legislative & Governmental – *Chair: J. Brock McClane*
- Liaison – *Co-Chairs: David S. Willig & John H. Rooney*
- Litigation & Arbitration (ILAC) – *Chair: Michael A. Tessitore*
- Membership & Benefits – *Co-Chairs: Alexander Reus & Heidi A. Schulz*
- Publications – *Chair: Francesca Russo-Di Staulo*
- Russia & Eurasia – *Co-Chairs: Maxim Istomin & Natalia Poliakova*
- Taxation – *Chair: William H. Newton, III*
- Technology & Communications – *Chair: Francisco A. Corrales*
- Travel Law – *Chair: Laurence D. Gore)*

Our committees and volunteers accomplished much progress, including:

Executive Committee: (a) analyzed, planned and implemented an outstanding new website and adopted more modern technology (e.g., list serve); (b) encouraged new projects and events (e.g., the International Commercial Arbitration Competition in Vienna, Austria); (c) significantly improved the Section's organization.

European Committee: (a) organized a 5th outstanding **International Investment Symposium** in Miami in April 2005, focusing on the legal and practical considerations involved in direct investments (real estate, mortgages, private equities, natural resources…) inbound into Europe, Russia and North America – with an amazing website: www.International-Symposium.com; with more than 200 attendees (including stellar speakers from Europe, Russia & North America) and with a spate of exciting events, including a gourmet dinner at Villa Vizcaya and an International Art Exhibition & Charitable Auction; and also (b) significantly improved our European contacts & partner organizations.

Faculty Committee: (a) expanded its members to include every prominent law school in Florida; (b) improved the student-practitioner-CLE relationships; and (c) assisted in organizing the Vienna Arbitration preliminaries involving the law schools of University of Miami; University of Florida; St. Thomas & Stetson.

International Litigation & Arbitration Committee ("ILAC"): (a) organized the Annual Arbitration Seminar in Oct. 2004, which was of the highest quality and heavily attended; (b) sponsored the Vis International Arbitration Competition, including the preliminary rounds in Orlando and the ultimate round in Vienna, Austria, where the Stetson Law School team became **world champions!**; (c) worked on various legislative initiatives, including amendments to Ch. 685 Florida Statutes; and (d) organized the annual litigation update seminar scheduled May 20, 2005.

Legislative & Governmental Committee: (a) monitored & weighed-in on several major legislative issues, including: Ch. 685 (jurisdiction in Florida as dispute resolution forum); Ch. 55 (easing domestication of foreign judgments in Florida); Ch. 48 (service of process on foreign corporations); and (b) communicating with various legislators & lobbyists.

Liaison Committee: Consisting of numerous section members committed to maintaining high-level contacts worldwide with Bar and similar professional organizations, our Liaisons have interfaced with some 16 national or regional organizations (e.g., Inter-American Bar Association; International Bar Association…). Of particular interest, our liaisons strongly supported the Section's International Legal Programs.

Membership Committee: (a) developed a PowerPoint presentation to demonstrate the application of international law issues in Florida; (b) is organizing an ILS Awareness Taskforce to promote membership; (c) is

analyzing the possibilities of increasing ILS member benefits; and (d) has appreciably increased ILS membership.

Publications Committee: (a) has published the Summer, Winter & Fall International Law Quarterly, containing thoughtful articles; (b) has refined the Gary Vause Memorial Scholarship Writing Contest (awarding prizes to Florida law students for outstanding, scholarly writings); and has in general supported Section events.

Russian & Eurasian Committee: (a) coordinated with ABA-CEELI the summer visit to Tallahassee by senior leaders of the Russian Federal Bar Association (65,000 members); (b) created the US-Russia Internship Program, wherein young Russian law students were actually received in Florida for legal training in July 2004 by Florida law firms; (c) actively assisted in the organization of the **International Investment Symposium** scheduled in Miami April 2005, including convincing major Russian legal and economic figures (including Russian personalities, the Vneshtorg Bank, AIZHK-the Russian "Fannie Mae") to attend.

Tax Committee: (a) has supported our various seminars and furnished international tax speakers for the International Investment Symposium; and (b) is currently organizing its **International Estate Planning Seminar** for October 2005.

Technology & Telecommunications Committee: (a) has accomplished major improvements to our Website (with a new webmaster and design underway); (b) has performed outstanding and extensive information gathering, processing & evaluations in order to improve our Section's technological platforms for today and tomorrow.

Travel Law Committee: (a) is studying the potential benefits of associating with an excellent travel agency; (b) continued its affiliate work with IFFTA (International Forum of Travel & Tourist Advocates) which will meet again in Vienna, Austria in August 2005.

In short, our Section has been very active and has accomplished much this year. The enthusiasm and hard work of our volunteers - and indeed of our Committees- deserves the highest praise. Our Section Coordinator, Angela Froelich, also deserves special accolades. Many individuals deserve special mention, which editorial constraints preclude!

We look forward to inviting more active participation by new members, as we try to build our Section to world-class excellence! Please join us!

Lucius Smejda
2004-2005 Chair
International Law Section

SYMPOSIUM

from page 1

recognition of notarial acts and deeds on international levels.

On Sunday evening, approximately 150 participants attended the Consular Corps Honors Reception (held in the beautiful Sky Lobby of the Bank of America Tower). The Honorable Ambler Moss, former U.S. Ambassador to Panama, served as Master of Ceremonies. Greetings and speeches were delivered by:

- U.S. Congressman Allen Boyd (Florida);
- Yuriy A. Kozlov, Chairman of the St. Petersburg (Russia) Council of Judges;
- The "Batonnier" (President) of the Paris Bar;
- Jaume Alonso-Cuevillas, Dean of the Barcelona Bar;
- Senator George Firestone, Florida Secretary of State (ret.);
- Dr. Horst Schmid, International Trade Minister of Canada (ret.).

Numerous international personalities attended this event, including:

- Jose Antonio Rivas, Trade Commissioner of Mexico in Miami;
- Dr. Carl M. Kuttler, Jr., President of St. Petersburg College (Florida);
- Prof. Valery Musin, St. Petersburg State University Law School (Russia);
- The Consuls of Germany, Canada, Albania, Costa Rica, and other countries.

The International Law Section awarded bronze plaques honoring:

1) two partner organizations (the Barcelona and Paris Bars); and
2) three international notary organizations (British, Russian and French).

Workshop session

The Paris Bar awarded its "official medal" to The Florida Bar International Law Section recognizing the Section's efforts to improve international legal cooperation. In addition, a cooperation agreement was signed by the International Law Section and the Russian Bar, which is designed to strengthen and increase future cooperation.

The professional program began on Monday, April 25. Over the two days of lectures and workshops, a faculty of over 60 distinguished professionals from North America, Europe and Russia provided their insight into topics relating to international investment. The smaller workshop sessions provided greater interactive participation as well as substantial networking opportunities. The lectures and workshops proved to be a

The "Miami Magic," a private yacht which toured Biscayne Bay.
(Courtesy of www.holidayofmagic.com)

continued, next page

SYMPOSIUM

from page 3

unique opportunity for participants to familiarize themselves with some of the issues that they or their clients may encounter when doing business or investing internationally. This program was approved for 17.5 CLE credits, including 2 ethics credits. Specifically, on this day, the topics discussed included analysis of investment proposals, corporate and tax considerations, and notarial practice.

On Monday night, participants and speakers attended a banquet at the magnificent Villa Vizcaya on Biscayne Bay. After an elegant cocktail reception on the terrace, guests were invited inside the historical landmark for a memorable gourmet dinner, accompanied by classical harp music.

Lectures resumed in good spirits on Tuesday, where the faculty focused on topics such as methods of dispute resolution, risk evaluation, financing international investments, ethical considerations for international investors, and immigration. Some of the workshops on this day focused on investing in specific jurisdictions (including Canada, Ukraine and Russia).

On Tuesday Night, a cocktail reception and charitable art auction was held, which raised over $11,000 for Best Buddies®, a nonprofit organization dedicated to enhancing the lives of people with intellectual disabilities by providing opportunities for one-to-one friendships and integrated employment.

The Florida Bar International Law Section was extremely pleased that the goals set forth for this International Symposium were met with success. We wish to thank all participants, sponsors, speakers and organizers for their extraordinary efforts, which were the keys to this success.

The organizers of the Symposium have created a set of CD-ROMs gathering valuable documents (e.g., lectures and workshop transcripts, over 500 "live" pictures taken, certain significant "economic" documents and a business card exchange section). These CDs are available for sale on the Symposium online store at www.internationalsymposium com.

For more information on the Miami Symposium and future events, please visit our website at www. international symposium.com.

Villa Vizcaya

Left to right: Dr. Horst Schmid, Sen. George Firestone, Lucius Smejda, Esq., Congressman Allen Boyd, Hon. Ambler Moss and Maxim Istomin, Esq.

Painting by Britto

Sponsor Booth

Steve Johnston, Helen Teplitskaia

Taxation of Cuban Confiscated Assets After Property Claims Settlements: Issues for Taxpayers and the US Government

by Timothy Ashby and Tania Mastrapa[1]

Introduction

From 1959 onward, the Cuban revolutionary government confiscated assets such as homes, businesses, farms, factories and personal property belonging to US taxpayers and others.[2] This was the largest seizure of US property in history, greater than the value of American assets taken by all other Communist governments combined.[3] Although the Castro regime promised compensation for confiscated properties, most takings were uncompensated. As a result, a number of US corporate and individual taxpayers took deductions on their income tax returns.

Claims for confiscated assets remain one of the most contentious issues between the United States and Cuba. A statutory condition for normalizing relations with a post-Castro Cuban government is whether the regime has taken "appropriate steps to return to United States citizens (and entities which are 50 percent or more beneficially owned by United States citizens) property taken by the Cuban government from such citizens and entities on or after January 1, 1959 or to provide equitable compensation to such citizens and entities for such property."[4] Nonetheless, normalization of US-Cuban relations is inevitable, and US claimants will receive settlements in the form of recovery of their properties or compensation. The tax implications of such settlements are substantial, as current estimates of the total value of US certified claims, including 46 years of accumulated interest, range from $6.4 billion to $20.1 billion.[5]

This article examines prospective treatment under the Internal Revenue Code ("IRC") of US taxpayers who may recover properties or receive compensation for confiscated Cuban assets. The issue is complicated by the fact that many of the one million Cuban exiles and their legal heirs who are now US taxpayers did not file claims or take deductions for confiscated properties, yet will presumably have their assets restored or receive various forms of compensation. While taxpayers who are fortunate enough to recoup their actual properties will probably not be subject to taxation except for the amount taken as a deduction for losses, such claimants may be a minority.

The majority of claimants may receive other forms of compensation that will be subject to US taxation. Given the special circumstances of the Cuban Diaspora, and precedential Internal Revenue Service ("IRS") treatment for assets taken by the Cuban government, the article recommends legislation to relieve certain categories of taxpayers of such inequitable liabilities.

Background

The 45-year-old US embargo on Cuba was enacted to retaliate against Cuba's confiscation of property owned by US citizens and corporations. Under Cuba's Law No. 851, the revolutionary government was authorized to nationalize, through forced expropriation, property held by US nationals.[6] Fidel Castro was given the power to appoint persons or agencies to administer the nationalized properties and appraisers to determine their value. Law No. 851 provided for payment to be made, based on the appraised value of the expropriated property.[7] An eventual accounting was to be made to the original owners of confiscated assets, but none occurred.[8]

Initially, Cuba offered compensation for nationalized assets based on 30-year bonds at 2 percent per annum interest in exchange for preferential sugar quotas.[9] The proposal was rejected and the US declared that the confiscations were illegal under international law because they were discriminatory and did not provide prompt, adequate and effective compensation. In 1964 Fidel Castro reportedly offered to pay $1 billion as compensation for confiscated US properties and to release political prisoners in exchange for US restoration of the Cuban sugar quota. This proposal was similarly turned down by the Johnson administration.[10]

The confiscated US assets included 90 percent of all electricity generated on the island (Cuban Electric Company), the entire telephone system (ITT), most of the mining industry (Moa Bay Mining Company and Nicaro Nickel Company), and large tracts of high quality land (between 1.5 and 2 million acres).[11]

In October 1964, the US Congress amended the Foreign Claims Settlement Act of 1949 and established a Cuban Claims Program under Title V of the Act. Under this program, the Foreign Claims Settlement Commission ("FCSC") considered claims of US nationals against the government of Cuba for their property losses. The FCSC received 8,816 claims of which 87 percent were from individual US citizens. The Program certified 5,911 of these claims totaling $1.8 billion, of which $1.6 billion were US corporate losses from such major American companies as General Motors, United Brands, Borden, International Paper, and Amstar. Assets taken from the ten largest corporate claimants – including electric and phone companies, two oil refineries, one nickel mine and five sugar producers – were ultimately certified to be worth over $1 billion in 1964. The FCSC also evaluated international law and determined that certified claimants were entitled to 6 percent per annum simple interest on the value of their claims from the date of the actual loss to the date of settlement.[12]

Over a million Cuban exiles who are now US taxpayers also had their property seized by the Castro government.[13] These assets were more extensive and varied than claims originally certified by the FCSC, including thousands of personal residences,

continued, next page...

large agricultural properties, insurance policies, and valuable personal property such as antique paintings and furniture.[14] The value of Cuban exile claims was estimated as $6.9 billion at 1957 values, which was equivalent to $20.02 billion in mid-1993.[15]

In 1962, the IRS, which had been awaiting Congressional action to define deductibility for specific Cuban losses, issued a formal ruling ahead of the US Congress. The IRS stated that, "[t]he taking of property without compensation is confiscation. It is no less confiscation because there may be an expressed interest to pay at some time in the future."[16] The ruling covered how to claim losses when filing income tax returns including: 1) year of deductibility; 2) a five-year carryover period for the unused portion; and 3) the nature of the loss whether capital or ordinary. According to a previous Supreme Court Ruling, the affected taxpayer was not obligated to establish that there was no possibility of restitution.[17]

Congress specifically addressed Cuban confiscation losses in the Revenue Act of 1964.[18] This law gave taxpayers the option of electing to carryover that portion of a net operating loss rising from foreign takings for ten successive years rather than a three-year carryback and a five year carryover.[19] It also added a new subsection under IRC §165 which provided that any loss of tangible property by Cuban confiscation was to be treated as a casualty loss. The amendment treated both business and purely personal confiscations of tangible property as casualty losses.[20]

The legislation allowed for the losses to be deducted from the income earned, capital or ordinary, by the taxpayer affected by the confiscations. The losses provided a limited benefit to those affected by reducing income taxes for periods subsequent to the property takings (in the carryover period). Numerous Cuban exiles who became US taxpayers (not necessarily naturalized citizens) and subsequently lost their properties to confiscation measures were able to use these deductions.

Before 1964, losses sustained through confiscation or seizure of property by a foreign sovereign were not eligible for casualty or theft losses. Confiscation losses incurred by taxpayers were deductible only when assets were held for business or investment purposes. Jewelry, residences, and other personal property confiscated by the Cuban government could not be taken as casualty losses.[21]

Under §238 of the Revenue Act of 1964, an amendment to the tax code provided that any loss of tangible property resulting from expropriation, intervention, seizure or similar taking by the Cuban government, and was not a loss incurred in a trade or business or in a transaction entered into for profit, was considered a casualty loss.[22] The amendment allowed for casualty loss deductions to be extended with limitations to "non-business properties" for those who were US citizens or residents before December 31, 1958.[23] This created a difference between those who were US taxpayers when Castro took over and those who became fiscal residents after January 1, 1959.

Prior to 1971, IRC §172 applied to confiscated investment property under which the confiscation loss was treated as an ordinary loss subject to carryover or carryback only to the extent of the taxpayer's investment income. In 1971 the tax code was amended regarding losses sustained in taxable years ending after December 31, 1958.[24] A special exception allowed Cuban losses to be carried over for 20 years so that the numerous immigrant taxpayers – whose income levels were insufficient – could use more of the losses.[25]

Tax Treatment of Restituted Assets

Restitution is the process by which land or other property that was forcibly removed from its owners is restored. When the restoration of the original property is not possible compensation of equal value is provided. Compensation for confiscated assets consists of two elements: (1) the type of remedy available and (2) the scope of the remedy.[26] During the process of normalizing US-Cuban relations, taxpayers can expect to receive various forms of settlements for their property claims. Remedies will range from actual restoration of original real estate and personalty, substitution for another property of equal value, vouchers redeemable for substitution, future cash payments, shares in joint ventures, privatized companies or investment funds, bonds, or other debt instruments.

The Joint Corporate Committee on Cuban Claims ("JCCCC"), an organization of 54 major US companies that had their property confiscated by the Castro regime, proposed that holders of certified claims should receive negotiable tax credits in full settlement.[27] Another JCCCC suggestion was the establishment of a fund that would be the vehicle for a broad based royalty program which included Cuba's natural resources in nickel, copper, iron ore, petroleum, and other foreign exchange generators such as tourism. Claims would be paid to their full value from the accumulation and reinvestment of royalties.[28]

Actual Restitution of Property

In general, return or recovery of property that was once the subject of a deduction must be treated as in-

The *International Law Quarterly* is prepared and published by the International Law Section of The Florida Bar.

John H. Rooney, Jr., Miami ..... Chair
Francesca Russo-Di Staulo, Miami ..... Chair-elect / Newsletter Editor
Angela Froelich, Tallahassee ..... Program Administrator
Lynn M. Brady, Tallahassee ..... Layout

Articles between 3 and 10 pages involving the various disciplines affecting international trade and commerce may be submitted on computer disk with accompanying hard copy, or via electronic format in Word or WordPerfect (with the use of endnotes, rather than footnotes.) Please contact Francesca R. Di Staulo at FDistaulo@kpkb.com for submissions to the *Quarterly* and for any questions you may have concerning the *Quarterly*.

come in the year of its recovery unless initial use of the loss did not provide a tax saving.[29] Only the actual amount of loss is used, not the allowed deduction. The recouped property is taxed at the rate in effect during the year in which the recovered asset is recognized as a factor of income,[30] unless the taxpayer did not obtain tax benefits from the deductions.[31] IRC section 111 states that "[g]ross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed…"[32]

When an original property is restored to the taxpayer or his second tier heirs, no taxable event has occurred that would constitute realization of income if no deduction was taken for the loss or any deductions taken were not fully used.[33] Taxpayers who took loss deductions on recouped properties would be liable to the US Treasury only for the amount of deductions; they would not owe any excess on their basis despite the asset's appreciation in value.[34]

When the government of Cuba (current or post-Castro) addresses the property confiscations of US taxpayers it will need to determine if it will follow any of the Central-Eastern European models or create its own for resolving claims. Several issues will make the actual restoration of original properties complicated if not impossible. For instance, if the governments of Cuba and the United States reach a bilateral compensation agreement then certified claimants (who have not already sought a resolution to their property claims independently) will receive payments distributed to them by the US government. At that point the restoration of their properties is no longer an option because they will have been compensated.

From 1959 to 1963, over 85,000 new homes were built on confiscated land. In October 1960, Cuba's Urban Reform Law turned 85 percent of renters into "owners."[35] The Cuban government recognizes adverse possession. If US taxpayer claims are addressed during the current regime then those Cubans who received property titles to confiscated residences will retain their "rights".[36] A

continued, next page

2005-2006 Section Calendar

2005

August 31	**Deadline for Summer 2005 issue of the International Law Quarterly** *Submit articles to Manjit Gill at msgill@becker poliakoff.com*
August 26	**Section Retreat (Members Welcome)** The Florida Bar BOG Meeting 12:00 p.m. - 6:00 p.m., Friday Don CeSar, St. Pete Beach Hotel Reservations: Don CeSar - 727/360-1881 Group Rate: $134 Deadline: August 10, 2005
August 27	**Chair & Chair-Elect Meeting with BOG** The Florida Bar BOG Meeting 9:00 a.m. - 5:00 p.m., Saturday - Don CeSar, St. Pete Beach
October 14	**International Income Tax and Estate Planning seminar** 8:00 a.m. - 4:40 p.m., Friday Hyatt Regency Downtown Miami Hotel Reservations: Hyatt Downtown Miami - 305/358-1234
October 31	**Deadline for Gary Vause Scholarship Writing Contest** Submit articles to Francesca Russo-Di Staulo at fdistaulo@kpkb.com or Sam Mandelbaum at srm@ManFitzLaw.com
November 15	**Deadline for Fall 2005 issue of the International Law Quarterly** *Submit articles to Manjit Gill at msgill@becker poliakoff.com*
December 15-16	**International Law Section Executive Council Meeting/ Reception** (Members Welcome) The Florida Bar BOG Meeting Windsor Court Hotel, New Orleans

2006

January 18	**International Law Update & Certification Review seminar** The Florida Bar Midyear Meeting Hyatt Regency Downtown Miami
January 19	**International Law Section Executive Council Meeting** (Members Welcome) The Florida Bar Midyear Meeting Hyatt Regency Downtown Miami
February 9-10	**27th Annual Immigration Law Update seminar** Hyatt Regency Downtown Miami
April / May	**Litigation and Arbitration Update seminar** Miami
June 23	**International Law Section Executive Council Meeting** (Members Welcome) The Florida Bar Annual Meeting Boca Raton Resort & Club

post-Castro regime may also recognize adverse possession in the name of social stability in addition to reducing a potential deluge in restitution claims.

Another Cuban reality that makes the return of original assets unlikely is the present condition of many such properties. Throughout the Castro regime some confiscated residences and other structures have been demolished. Many buildings have collapsed due to deterioration and others are irreparable.[37]

Assets Received as Substitute Restitution

Under IRC §1033(g), if property has been compulsorily or involuntarily converted (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof), no gain shall be recognized if it is converted into property that is similar or related in service or use to the property.[38] The criteria for "similar or related in service or use to the property" are generally interpreted broadly by the IRS and tax courts.[39] Section 1033 applies to both property held for personal use and assets held for productive or investment use.[40]

Such conversions will probably be recognized as non-taxable exchanges (also known as an unrecognized gain or loss), which is an exchange in which a taxpayer is not taxed on any gain and on which any losses cannot be deducted. The tax code considers that the basis of property in a non-taxable exchange is usually the same as the basis of the property transferred.

Therefore, if taxpayers have not taken deductions for confiscated property, they will presumably not be subject to taxation even if the substituted asset is worth substantially more than the basis of the original property in 1960 dollars. However, if the substituted property is sold, the amount over the basis will be included in taxable income of the restituted owner.

Monetary Compensation

Under Section 1033(a)(2), the IRS would probably classify monetary compensation received in lieu of confiscated Cuban property to be a taxable exchange.[41] A taxable exchange occurs when cash or property (e.g. bonds or shares) is received that is not similar or related in use to the property exchanged. The basis of the property received is usually its Fair Market Value ("FMV") at the time of the exchange. If property is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, any gain is recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property.[42]

This would impose an inequitable burden on taxpayers if a cost basis dating from 1960 back into the early 20th century is used, as many residences and businesses were acquired decades (and in some cases, centuries) before the 1959 Revolution. This is demonstrated by claims filed by Citibank and Chase Manhattan. Citibank (which had eleven Cuban branches confiscated) had been engaged continuously in branch banking in Cuba since 1915, and Chase (which lost four branches) had been on the island since 1925.[43] On its books Chase listed its real estate holdings at a depreciated cost of $110,232. The last appraisal of any Chase branches was made on March 28, 1960, and applied only to the Havana office. This valued the premises owned by Chase at $165,090, and the necessary adjustment to bring the book value for that property to market was stated as $54,858.[44] Today this building is worth at least $400,000, and within a year after normalization of relations its value will probably double.

The IRC allows taxpayers whose property has been compulsorily converted into money or dissimilar property to avoid a taxable gain by (a) purchasing similar property with the proceeds within two years, or (b) purchasing a controlling interest (i.e. 80 percent of the total combined voting power of all classes of stock and at least 80 percent of the total number of shares of all other classes of stock) in a corporation owing such other property.[45] It would be unreasonable to expect that most compensated taxpayers would be willing or able to buy similar properties (in the US or Cuba), and it is unlikely that there would be many opportunities for even large US companies to purchase a controlling interest in corporations owning similar Cuban properties within two years after compensation. Furthermore, Section 1033 may not apply to Cuban properties, as Section 1031(h)(1) stipulates that real and personal property located in the US and outside the US are not considered property of a like kind.[46]

In addition to compensation for property losses, the IRS will also have to consider treatment of tort claims and settlements of judgments against the Cuban government for confiscations or damages to persons or property.

Valuation of Assets

Another major issue that will confront taxpayers is how the IRS will value restituted properties or compensation. The US government stated the total book value of confiscated US investments in Cuba to be $956 million.[47] Even though many industrial assets will have lost their original economic value (e.g. sugar mills built in the 1920s), the discrepancy between book value and FMV after nearly half a century will be enormous in most cases. For example, in June 1994, the Mexican firm Grupo Domos purchased 49 percent of EmtelCuba for $1.5 billion which represented half of Cuba's generally antiquated telephone system.[48] In comparison, in 1960 the FCSC allowed ITT a claim of $130.7 million for Cuba's *entire* telephone system.

Under the provisions of the Tax Reform Act of 1976, the amount of casualty losses subject to deduction were based on the FMV of any confiscated property immediately prior to the time the loss was sustained.[49] The IRS will presumably value properties at their FMV price in Cuba at the time compensation or restitution takes place because the FMV of any confiscated property immediately after the time when the loss was sustained was considered to be zero.[50]

The Helms-Burton legislation contemplates that, with limited exceptions, US courts will adopt the valuations determined in awards issued by the FCSC's Cuban Claims Program, conducted from 1965 to 1972.

In cases where a plaintiff was not eligible to file a claim (i.e. was not a US national at the time of confiscation), the legislation authorized the US District Courts to appoint the FCSC as Special Master to make determinations on such issues as ownership of property, for use in court actions.[51]

Applying half-century-old valuations to properties in a market that will probably grow as fast as that of the East Berlin real estate sector in the post-Communist era would be unrealistic and unfair to claimants.[52] For example, in Havana's upscale Miramar district, where many Cuban exiles lived, a 31-apartment complex was built in the late 1990s by Real Inmobiliaria, a joint venture between Monaco-based Pastor and Lares, the real estate arm of Cuba's Cubalse corporation. The apartments – priced from $94,000 for a studio to $400,000 for a penthouse – sold out in weeks to foreign buyers.[53]

Successors in Interest

Another issue is how the IRS will treat successors in interest. Since the 1960s, a significant number of the 78 publicly owned US corporations that suffered asset seizures in Cuba have been merged, acquired or dissolved. For example, after the wholly-owned Cuban subsidiary of Canada Dry Corporation was taken, the company took a charge against the subsidiary's consolidated earned surplus of $856,202 plus a write-off of $309,875 of the investment in and advances to the Cuban company.[54] Canada Dry changed hands repeatedly in the 1980s – first to Del Monte Corporation, then to Dr. Pepper, and then Norton-Simon. In 1986 Cadbury Schweppes, PLC paid $230 million for the company, and subsequently sold the Canada Dry brand's worldwide rights (excluding US and France) to Coca-Cola.

Generally, the corporation surviving a statutory merger assumes all the powers, rights, debts, and liabilities of the corporation merged into it.[55] The successor corporation becomes primarily liable with regard to the tax liabilities of the merged entity. Assuming that Cadbury acquired Canada Dry's assets and liabilities, it would be the *de jure* successor in interest for both future claims and restitution tax liabilities due to its US operations.

Three US banks had their Cuban branches nationalized. First National City Bank (now Citibank) took bad debt charges of $38 million on uncollectible loans and $11 million on other losses, including bank properties.[56] First National Bank of Boston charged off $5.3 million to its reserves after its six Cuban branches were seized. Renamed the Bank of Boston, it merged with BayBank in 1995, changing its name to BankBoston. In 1999 that firm merged with investment bank Fleet Financial Group to become FleetBoston Financial Corporation. Bank of America acquired this entity in April 2004, and is the successor in interest. The third bank, Chase Manhattan (now part of JP Morgan Chase), did not report Cuban losses, probably because it held Cuban government funds at its New York Branch.[57]

A further example of the accounting and legal complexities that will be involved in Cuban settlements is the case of Moa Bay Mining Company, which claimed $88.3 million in confiscation losses. The company was wholly owned by Freeport Nickel Company, a subsidiary of Freeport Sulphur Corporation. Freeport Sulphur merged with McMoRan Oil & Gas, LLC in 1998 but remained a wholly owned subsidiary of the successor company McMoRan Exploration Co. ("McMoRan"). In 2002, McMoRan sold Freeport to a 50-50 joint venture between IMC Global Inc. – the world's largest purchaser and user of sulphur – and Savage Industries Inc., a major materials management and transportation systems company.

The possible compensation for Moa Bay's Cuban assets should be of interest to IMC and Savage, as the current value of the confiscated nickel and cobalt mines is estimated at $5-7 billion. Since 1990, Canada's Sherritt International corporation has invested over half a billion dollars in Freeport's former mines under a joint venture with the Cuban government, and China is negotiating a similar joint-venture.[58] Cuban nickel is considered to be Class II with an average 90 percent nickel plus content. Holguin Province, where the Moa Bay mines are located, is estimated to contain 34 percent of the world's known reserves, or some 800 million tons of proven nickel plus cobalt reserves, and another 2.2 billion tons of probable reserves.[59]

Assignment or Relinquishment of Claims

Chase Manhattan employees who had been forced to flee Cuba were compensated by the bank for the value of any property which they had left behind (all of which was confiscated by the Cuban government). The compensated employees assigned to Chase any claims they might have against Cuba arising out of the confiscation. Chase attempted to assert these assigned claims as a set-off against its liability to Cuba's state-owned Banco Nacional as a result of Chase's failure to return to the Cuban bank a $7,256,000 surplus which had remained after Chase liquidated Banco Nacional's loan collateral after the Revolution. Although the 2nd Circuit court admitted that the "assignors of the claims had a special relationship to Chase, and indeed Chase had a moral obligation, and perhaps a legal one to reimburse them for their losses," the court disallowed the set-off, holding that it extended only to Chase's confiscated Cuban property, and not the property of others confiscated, even when such assignments were given to Chase for a proper purpose and for full value paid.[60]
The court's rationale was that:

> "To hold otherwise would call up a brisk trade in claims against foreign states, and would in effect nullify the Act of State doctrine, and prevent access by the Government of Cuba to the United States courts against any United States defendant having the willingness and creativity to buy up Cuban claims of others to assert as assignee."[61]

Although this ruling was intended to forestall speculation in Cuban claims, it may have an adverse effect on compensated taxpayers who legitimately acquire claims (e.g. by deed or gift) from others and seek to use losses as set-offs or deductions.

Some taxpayers may choose to relinquish their property claims rights or give them to relatives or friends because they are not interested in their properties or compensation.

continued, next page

Taxpayers who relinquish claims may nonetheless be liable for taxation. Generally, the position of the IRS is that assigned claims or property fall under the "assignment of income" doctrine, under which the taxpayer cannot avoid recognizing income by assigning it to another person, unless his renunciation of the property legally amounts to an abandonment of his rights without a transfer of rights to another.[62]

Taxpayers who give claims rights to friends or relatives as gifts are subject to gift tax on the transfer, with the statutory annual exclusion.[63] The value of the gift is excluded from the recipient's gross income, regardless of the amount of the gift. Relinquishing the right to the property/compensation may be interpreted as a gift to the Government of Cuba.

Legislative Proposals

As noted above, US taxpayers (including Cuban exiles) whose properties were taken by the Castro regime may suffer additional victimization under IRC §1033 (a)(2)(A) if they receive compensation at current FMV, which in most cases would be a large multiple of their basis in the property. Many of such claimants are elderly and living on fixed incomes and would be unable to pay income tax on compensation received for properties that may now be worth millions of dollars. For example, in 2004 a 95-year-old woman filed an action in a federal court against the Club Med hotel chain for building a 337-room luxury resort on Varadero beachfront property confiscated from her family, which had also owned prime real estate occupied by two other hotels, one owned by Sandals and another by Ibero-Star.[64]

One solution may be for the US Congress to enact legislation to allow qualifying taxpayers to exclude compensation payments from taxable income. A precedent is the 2001 Economic Growth and Tax Relief Reconciliation Act which allowed Holocaust survivors, their heirs or estates to receive the full benefit of any compensation payment made by governments or industry by excluding from income taxes compensation payments received after January 1, 2000.[65] It can be argued that Cuban exiles (and US nationals) were similarly victims of tyranny and should not be unfairly burdened by being taxed on monetary compensation if their actual properties cannot be restored.

An argument can be made that it would be discriminatory to allow taxpayers (who did not take a tax deduction) to receive restituted or substitute properties tax-free under §1033, whereas those who receive monetary compensation that exceeds the original basis of the property (which may happen in most cases), will have the excess taxed as ordinary or capital gains.[66] This would be contrary to the doctrine of horizontal tax equity, under which taxpayers in similar circumstances should be taxed in similar ways. This doctrine has a constitutional foundation; under the equal protection clause, tax legislation enjoys the greatest degree of freedom to classify.[67]

Conclusion

When the normalization of US-Cuban relations commences, the IRS will be confronted with unprecedented tax issues. In addition to Fortune 1000 US companies, as many as one million Cuban-American taxpayers may have property claims against assets valued in tens of billions of dollars. Because of the unique circumstances involving politics, history and geography, the US government will need to address these special tax circumstances in ways that redress past injustices and encourage positive economic changes in Cuba.

Endnotes:

1 Timothy Ashby, JD, is a Special Counsel with the Miami office of Duane Morris LLP. Formerly a senior official with the US Commerce Department, he also holds PhD and MBA degrees. Tania Mastrapa is a principal with Mastrapa Consultants in Miami. She holds a MALD from the Fletcher School of Law and Diplomacy and will receive her PhD in International Studies from the University of Miami in Summer 2005.

2 US taxpayers are fiscal residents, not necessarily citizens or permanent residents.

3 Statement of Senator Richard Stone (D-FL), *Outstanding Claims Against Cuba, Hearings Before Subcommittees on International Economic Policy & Trade, and on Inter-American Affairs, Committee on Foreign Affairs, House of Representatives,* 96th Cong., Sept. 25, 1979, at 6 (1980).

4 H.R. 927 CUBAN LIBERTY AND DEMOCRATIC SOLIDARITY (LIBERTAD) ACT, §205 (b)(2)(D) (1996).

5 Joint Corporate Committee on Cuban Claims 2005.

6 The confiscations were officially called "interventions."

7 *Banco Nacional de Cuba v. Chase Manhattan Bank,* 505 F. Supp. 412, 422 (D.N.Y, 1980).

8 *Empresa Cubana Exportadora de Azucar y Sus Derivados v. Lamborn & Co.*, 652 F.2d 231, 234 (2d Cir., 1981).

9 James N. Wallace, *Move Termed Groundwork for Confiscation: Sugar Mills Are Likely 1st Target*, WALL ST. J., Jul 7, 1960, at 3.

10 Statement of John A. Cypher, Jr., *Outstanding Claims Against Cuba* at 12.

11 For example, North American Sugar Industries owned a tract of land approximately 42 miles by 30 miles (3,300 square kilometers) and three sugar mills, including two of Cuba's largest.

12 See *FCSC decision CU-0249, American Cast Iron Pipe Company.*

13 Under Law No. 989 all property of persons fleeing from Cuba was confiscated.

14 *Cuba Moves to Halt Insurance Payments to Refugees in U.S.*, WALL ST. J., Dec. 6, 1960, at 10.

15 José F. Alonso and Armando M. Lago, *A First Approximation of the Foreign Assistance Requirements of a Democratic Cuba*, in CUBA IN TRANSITION, Vol. 3, 202-204 (George P. Montalván ed., 1994). It is virtually impossible to assess the current value of these claims as many in the past decade have greatly deteriorated and collapsed. In 2003, 71 of 156 sugar mills were shut down. These will eventually become worthless.

16 *Tax Relief Given on U.S. Property Seized by Cuba*, WALL ST. J., Nov. 7, 1962, at 2. See Rev. Rul. 197, 1962-2 CUM. BULL. 66.

17 Robert Metz, *Taxes May Be Bar To Foreign Deals*, NY TIMES, March 5, 1961, at 1F. See also *United States v. White Dental Mfg. Co.*, 274 U.S. 398 (1927).

18 INT. REV. CODE OF 1954, §172(b) and (k) as amended, Rev. Act of 1964, §210.

19 Thomas Wolfe & John White, *Income Tax Consequences of Cuban Expropriations to Cuban Resident Aliens*, 19 U. MIAMI L. REV. 591, 601 (1965).

20 *Id* at 599-600.

21 *Assets Lost in Cuba Get Tax Deduction*, NY TIMES, Nov. 7, 1962, at 33.

22 *7 Mertens Law of Fed. Income Tax'n.* §28:102, Jan. 2005.

23 *Tax Report; A Special Summary and Forecast of Federal and State Tax Developments*, WALL ST. J., July 1, 1964, at 1. See also IRC §165(i) (as added by P.L. 88-348)

24 *S Rep No. 91-1544*, (91st Cong, 2d Sess 3).

25 Lawrence Axelrod & Jeremy Blank, *The Supreme Court, Consolidated Returns, and 10-Year Carrybacks*, 90 Tax Notes 138, 140 (March 2001).
26 Richard W. Barrett, *Avoiding the Expropriation Nightmare – Tax Consequences and Asset Protection Techniques*, 52 U. MIAMI L. REV. 831, 847 (1998).
27 Statement by Robert Hutton, vice chairman of Lone Star Industries, and chairman of the Joint Corporate Committee on Cuban Claims, *Outstanding Claims Against Cuba* at 8.
28 *Id.*
29 *IRC §1.111-1.*
30 *Sullivan Corporation v. United States*, 381 F. 2d 399, 403 (US Court of Claims 1967).
31 *IRS Revenue Ruling 1962, §165 – Losses*, 26 CFR 1.165-1: Losses.
32 *IRC TITLE 26, Subtitle A, Ch. 1, Subch. B, Pt. 111, §111.*
33 *IRC §1001 (b).*
34 Harold S. Peckron, *Reparation Payments – An Exclusion Revisited*, 34 U.S.F.L. REV. 705, 712-713 (Summer 2000).
35 *Instituto Nacional de Ahorro y Viviendas* (National Institute of Savings & Housing), Havana (March 15, 2005). Ownership in Communist countries is (and was) generally limited to the use of a property, not the right to sell or rent an "owner's" property or even improve it without the express permission of the State and with materials purchased from the State. In essence, rights are greatly restricted, if not altogether nonexistent.
36 Some countries like Bulgaria allowed for nominal "private ownership", particularly for residential properties throughout Communist rule. That is, occupants held title but enjoyed no ownership rights.
37 Nancy San Martin, *High Winds, old age threaten buildings throughout Havana*, MIAMI HERALD, Sep. 18, 2004, at 13.
38 *IRC §1033 (a)(1).*
39 *IRC §1-1033(g)(1).*
40 See *IRC §121 (d)(5)(B).*
41 *IRC §1.1033(a)(2)(c).*
42 *Id at §1033(a)(2)(A).*
43 *Banco Nacional* at 428.
44 *Id* at 459.
45 *IRC §1.1033(a)(2)(c).*
46 IRC §1033 provides no guidance on this issue, but §1031 is generally considered applicable in this regard.
47 *Survey of Current Business*, Table 3, at 22-23 (August 1961).
48 Ted Bardacke, *Mexican firm breaks new ground in Cuban telecom field*, DEVELOPMENT BUSINESS, July 31, 1994.
49 See MERTENS LAW OF FED. INCOME TAX'N §28:102, Jan. 2005. FMV is defined as the price at which a property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. *IRC Reg. §20.2031-1.*
50 "Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate." *IRC Reg. §20.2031-1,*
51 FCSC: 2001 Annual Report, FOREIGN CLAIMS SETTLEMENT COMMISSION OF THE UNITED STATES, US Dept. of Justice (2001).
52 Like Havana, the demand for housing in Berlin far exceeds the supply. Prices for residential properties in the most desirable parts of the city reach 6-7,000 EUR per sq, meter ($2,575-$3,000 per sq. ft.), and the average in the city is 2,300 EUR per sq. meter ($986 per sq. ft).
53 Pascal Fletcher, *Property development gives Havana partial facelift*, REUTERS, June 11, 1999.
54 *Sales Set Mark for Canada Dry*, NY TIMES, Dec. 10, 1960, at 29.
55 See *Missile Systems Corp. v. Commissioner*, T.C.M. 1964-212.
56 *Boston First National Charges Off $5.3 Million Loss to Cuban Seizures*, WALL ST. J., Jan. 20, 1961, at 16.
57 *Banco Nacional* at 146-147.
58 *Cubamine 501*, TED CASE STUDIES (American University 2004).
59 *Cuba and China Sign Deals to Expand Nickel Output*, METALS WEEK, Nov. 29, 2004, at 6.
60 *Banco Nacional* at 146-147.
61 *Id* at 147.
62 See *Commissioner v. Giannini*, 129 F. 2d 638 (9th Cir. 1942).
63 *IRC §102.*
64 Amy Driscoll, *Club Med built on property that Cuban exiles claim*, MIAMI HERALD, July 8, 2004, at 4.
65 *IRS News Release* No. IR-2201-75, (Aug. 30, 2001).
66 See *Salt River Pima-Maricopa Indian Community v. Yavapai County*, 50 F. 3d 739, C.A.9 (Ariz. 1995). (Tax is "discriminatory" if it is not imposed equally upon similarly situated groups.).
67 *Schulz v. New York State Executive, Pataki*, 960 F. Supp. 568 N.D.N.Y., 1997); U.S.C.A. Const. Amend. 14.

Constructing the Rules of the Game

By C. Ryan Reetz

One of the complaints most frequently expressed by trial lawyers about the arbitration process is that it is too flexible. Counsel complain that the most commonly-used sets of arbitration rules allow arbitrators too much discretion and prevent counsel from understanding in advance how a given arbitration will proceed. This sense of uncertainty is heightened in the international context, where parties, arbitrators, and counsel from different countries may have very different expectations concerning how the arbitration should be conducted.

For counsel that have been trained as trial lawyers – and taught the advantages of mastering procedural and evidentiary rules in litigation – the flexibility of arbitration procedures is threatening for at least two reasons. First, the resulting uncertainty undermines counsel's ability to plan the presentation of the case at the final hearing. Second, the absence of fixed norms eliminates the advantage normally held by the skilled advocate who has mastered a complex set of governing rules. Nevertheless, the same flexibility that at first glance appears to limit the advocate's role in arbitration actually creates an entirely new dimension of advocacy: the opportunity to participate in formulating the rules by which each arbitration will be conducted.

Flexibility in the Arbitration Process

Unlike litigation in the courts, where disputes are typically resolved pursuant to a detailed and well-developed set of procedural and evidentiary rules, most sets of arbitration rules confer virtually unlimited discretion on the arbitrator. For example, Article 16(1) of the American Arbitration Association's International Arbitration Rules ("AAA Int'l Rules") provides that

> Subject to these rules, the tribunal may conduct the arbitration in whatever manner it deems appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case.

Article 15(1) of the UNCITRAL Arbitration Rules ("UNCITRAL Rules") is virtually identical to the AAA provision.[1]

Similarly, the ICC Rules of Arbitration ("ICC Rules"), while somewhat more formalized in their approach, confer considerable procedural and evidentiary discretion upon the arbitral tribunal. Absent a governing provision of the Rules or an agreement of the parties, ICC proceedings are governed by "any rules which … the Arbitral Tribunal may settle on, whether or not reference is thereby made to the rules of procedure of a national law to be applied to the arbitration."[2] The issue of arbitral flexibility is even more striking in disputes in which the parties have not chosen to follow the arbitration rules of a particular institution. In such cases, many jurisdictions confer virtually unlimited discretion upon the arbitrator.[3]

"Rules of the Game"

Accordingly, in many arbitrations the tribunal is called upon to decide numerous procedural, evidentiary, and other issues that are neither addressed by the governing arbitration rules nor resolved by agreement of the parties. Because these decisions establish norms that are used to determine the conduct and outcome of the arbitration, they are as significant to trial counsel as the institution's written arbitration rules, and may themselves be viewed as rules that govern the particular arbitration proceeding. In contrast to institutional rules, counsel have the opportunity to argue for or against the adoption of case-specific rules as their clients' interests may require.

A broad variety of "rules" are available for consideration. Perhaps the most frequently-debated case-specific rules are those concerning the scope and permitted methods of pre-hearing discovery and disclosure.[4] Other potential rules concern the presentation of evidence at the final hearing, including whether witnesses testify live, by affidavit, or in a hybrid procedure; and, where live testimony is received, the manner of questioning and cross-examination.[5] Additional rules can include matters such as the appointment and use of experts (*e.g.*, arbitrator appointment vs. party appointment, expert reports, expert discovery, and mode of presentation);[6] the order of proof; time limitations on the parties' presentations; the order in which issues are considered (*e.g.*, bifurcation and expedited consideration of some issues, analogous to U.S. summary judgment procedures);[7] pre-hearing exclusion or admission of certain types of evidence (analogous to common-law motions *in limine*); and interim relief and conservatory measures.[8]

Indeed, under some circumstances, arbitrator-imposed rules may even revisit matters that appeared to be provided for in the parties' arbitration agreement, such as the location of hearings,[9] the substantive law to be applied,[10] and the language of the proceedings[11] – although the institutional arbitration rules attempt to avoid such determinations by emphasizing the primacy of the parties' agreement. In short, the types of rules available for formulation appear to be limited only by the creativity of counsel and the arbitrators.

Timing Considerations

The process of rule-determination often continues throughout the lifetime of an arbitration matter. However, counsel may find it advantageous to seek to establish the most important ground rules at the pre-hearing conference that is typically held in substantial arbitration matters.[12] In order to avoid claims of unfair surprise, and to make as persuasive a presentation as possible, counsel often choose to submit, in advance of the pre-hearing conference, written argument in support of the rules being proposed by counsel.

There is often a divergence of interest between counsel and the arbi-

trators with respect to when (and, indeed, whether) case-specific rules should be formally established. Counsel often desire greater certainty concerning the rules, so that they can more effectively plan the presentation of their case. In contrast, arbitrators may wish to defer – or avoid altogether – expressly establishing particular rules. Rather than ruling against one of the parties on a contested procedural issue, arbitrators often prefer to seek the parties' consent to following particular procedures or, failing consent, to pressure the parties to agree upon a compromise position. For obvious reasons, it is difficult for a party to later complain about a procedure to which it has consented. When consent and compromise are unattainable with respect to pre-hearing procedures, arbitrators are often more comfortable deferring decisions to the extent possible and ultimately allowing the parties a great deal of freedom at the final hearing, so that no party can complain of being frustrated in the presentation of its case.[13]

Counsel seeking to overcome arbitrators' reluctance to establish the rules at an early stage may argue that doing so will not only allow the parties to reduce their costs through more effective planning, but will also prevent the final hearing from becoming a free-for-all. Advance determination of the rules will result in a final hearing that is shorter, more efficient, more orderly, and less likely to involve unfair surprise. Counsel must, of course, consider whether such a hearing will further their clients' interests in each particular case.

Constructing the Rules

The considerable discretion conferred upon arbitrators to formulate case-specific rules means that, by definition, there are no controlling authorities and norms that require the choice of one rule over another. Moreover, because the arbitration process is intended to be different from litigation, commentaries, rules, and court decisions concerning civil procedure are of limited utility in providing standards for the conduct of arbitrations. Despite the absence of controlling authorities, however, there are a number of different means by which counsel may advocate adoption or rejection of a proposed rule.

1. The "Comfort Zone"

In general, an arbitrator will be most comfortable applying the procedural and evidentiary standards that he or she usually follows, whether the standards of the arbitrator's domestic litigation process or the set of norms that the arbitrator typically applies in arbitration. Persuading an arbitrator to apply rules that are within his or her "comfort zone" ordinarily should not require excessive effort.14

On the other hand, counsel may also seek to use the familiarity of particular standards as a negative example. Arbitration, counsel may argue, is supposed to be different from litigation; thus, the procedures followed should not necessarily mirror the litigation procedures with which the arbitrators are familiar. Indeed, the refusal of an arbitrator to give fair consideration to alternative procedures could be argued to be an unfair bias in favor of the arbitrator's (and, often, the adversary's) own legal system and practices.

2. "Persuasive Authority"

Counsel may look to a growing body of authorities that, while not formally binding upon arbitral tribunals in their formulation of rules for a particular matter, may nevertheless serve as persuasive authority counseling the adoption or rejection of a particular rule. For example, there is an increasing trend favoring the publication of redacted arbitral decisions,[15] which can be cited in subsequent cases. In addition, numerous excellent commentaries provide guidance and authoritative recommendations.[16]

Moreover, the institutional rules themselves contain standards that can be cited as providing values underlying a particular procedural or evidentiary decision. Each set of rules requires that parties be treated in an impartial manner, have the right to be heard, and have a reasonable opportunity to present their case.[17] These general principles may be argued to support or preclude particular case-specific rules being considered by the tribunal. Furthermore, other arbitral institutions' rules can be cited as evidencing widespread consensus on a particular issue. For example, each institution's rules permit arbitrators to grant interim relief and conservatory measures, suggesting that the primary arbitral institutions have all recognized the

continued, next page

legitimacy and propriety of such measures in arbitration.[18]

Finally, the parties may refer the arbitrators to other sets of rules as (arguably) demonstrating generally accepted and neutral standards that should inform the tribunal's formulation of a particular case-specific rule. The International Bar Association, for example, has promulgated a set of evidentiary rules for commercial arbitration that attempt to balance the concerns and considerations expressed by both civil-law and common-law practitioners. Even in cases where the parties have not expressly agreed to follow the IBA Rules, standards established in those rules may be cited as providing widely-recognized norms that do not favor parties from any particular legal system.[19] Similarly, the *Principles of Transnational Civil Procedure* approved by the American Law Institute and UNIDROIT, while not specifically designed for arbitration, identify a number of principles that may be argued to be important to the fundamental fairness of an arbitration proceeding.[20]

3. Arbitration "Articles of Faith"

Additional support for a party's position may be derived from the set of values that arbitration is designed to serve – which are typically described as advantages of the arbitration process vis-à-vis litigation. Proponents of arbitration almost universally represent it to be relatively informal, flexible, efficient, speedy, even-handed, consensual, expertise-based, focused on substance rather than form, and less adversarial than litigation. Accordingly, counsel may argue that any case-specific rules that would undermine these advantages would lessen the desirability of the arbitration process and frustrate the parties' expectations in choosing it over litigation.

4. Common Sense and Practical Judgment

Counsel are not, of course, precluded from directing appeals to the arbitrators' common sense and practical judgment. Indeed, the paucity of established procedural and evidentiary standards in the institutional rules suggests that arbitrators are intended to rely heavily upon these faculties in conducting arbitrations. The circumstances of a given controversy will often suggest that one means of proceeding is more practical and fairer than another. Once arbitrators are convinced, at a fundamental level, that a proposed rule is both fair and practical, it becomes virtually impossible to persuade them to reject their common-sense conclusions.

5. "Arbitral Due Process"

As a more formalized expression of a basic fairness argument, counsel may invoke the concepts of "arbitral due process" and a reasonable opportunity to present one's case. Not only are these values enshrined in the institutional rules; due process issues may also affect the enforcement of the ultimate arbitral award.[21] In making such arguments, counsel may draw upon an extensive literature discussing due process in the litigation context, including the ALI/UNIDROIT *Principles of Transnational Civil Procedure*.[22]

6. Policy Arguments

Proposed rules often may also be justified in terms of their broader policy implications. Perhaps the most common examples involve the reception of evidence. Counsel may argue for the exclusion of evidence of subsequent remedial measures and offers of compromise based upon the harms that would flow from deterring such socially beneficial measures.[23] The confidentiality of attorney-client communications may be defended by reference to the general need to avoid discouraging candid communications between client and counsel.[24] Sequestration of witnesses can be justified as preventing one witness' testimony from being improperly influenced by that of another.[25] Likewise, counsel may oppose both the submission of written testimony and permitting leading questions on direct examination based on the need to avoid improper suggestions to witnesses concerning their testimony.[26]

7. Conflict-of-Laws Analogy

Because the rule-selection process essentially involves asking the tribunal to adopt one proposed rule over another (and, frequently, the rules of one legal system over another), it is somewhat analogous to a conflict-of-laws analysis.[27] Accordingly, the factors typically considered in addressing conflict-of-laws problems may often have special resonance with the arbitrators. Relevant considerations may include, for example, the parties' legitimate expectations with respect to how their dispute would be resolved, the connections of the parties and the transactions at issue to the jurisdictions whose rules are being urged for adoption, the relevant states' comparative interests in providing the rule of decision, and arguments concerning respect for jurisdiction and sovereignty – as well as the underlying arguments in favor of particular approaches to resolving conflicts issues. These factors are most likely to be significant where the competing proposed rules reflect differing policy choices made by jurisdictions that each have significant connections to the dispute.

8. Enforcement Considerations

Separate and apart from the foregoing considerations, a powerful argument for adopting a particular rule is the possibility that the arbitral award may not be enforced if the rule is not followed. Thus, to the extent applicable, counsel may draw on the grounds for non-enforcement set forth in Article V of the New York Convention and of the Panama Convention. The most likely source of such an argument is the "due process" language of the treaties, which permits non-recognition of a foreign arbitral award where

> [t]he party against whom the award is invoked was not given proper notice … of the arbitration proceedings or was otherwise unable to present his case …

New York Convention, Art. V(1)(b), or

> the party against which the arbitral decision has been made was not duly notified … of the arbitration procedure to be followed, or was unable, for any other reason, to present his defense…

Panama Convention, Art. V(1)(b). These standards are often used, for example, to persuade arbitrators to hear evidence that another party

seeks to exclude.[28]

In addition, counsel may also raise enforcement considerations under the local law of the place of the arbitration. For example, in arbitrations held within in the United States, counsel may base their argument on the provisions of the [U.S.] Federal Arbitration Act, 9 U.S.C. §1 et seq. *See Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc.*, 126 F.3d 15 (1997). The U.S. statute permits arbitral awards to be vacated, *inter alia*,

> (2)Where there was evident partiality … in the arbitrators, or either of them.

or

> (3)Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

or

> (4)Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. §10(a). Moreover, a number of U.S. jurisdictions recognize "implied grounds" for vacating arbitral awards under the Federal Arbitration Act, such as "manifest disregard of the law", even though those grounds are not enumerated by the statute. *Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc.*, 126 F.3d at 23.

Limiting Factors

Although the institutional arbitration rules allow great latitude for the formulation of case-specific rules, even a creative advocate will still face some constraints on rule-formulation. As a practical matter, it is simply not possible to anticipate or resolve every potential issue before the final hearing. Moreover, it would be inefficient even to attempt to do so: the parties and the tribunal would be forced to develop a comprehensive body of procedural and evidentiary law for a single case. Furthermore, counsel who insist upon urging the adoption of a large number of case-specific rules risk creating the perception that they are engaging in "creeping legalism"[29] and either are overreaching or fundamentally misunderstand the arbitral process. Thus, as in other aspects of dispute resolution, trial counsel must focus their efforts on those issues that are important to winning the case.

In addition to the foregoing limitations, the institutional rules themselves do provide some minimal limitations on the scope of case-specific rule formulation. A colorful example is provided by the decision in *Larsen v. The Hawaiian Kingdom by its Council of Regency*, a dispute that was submitted by agreement to the Permanent Court of Arbitration at The Hague under what were ultimately determined to be the UNCITRAL Rules.[30] In that case, Mr. Larsen, a resident of Hawaii, brought a claim against an entity named as "The Hawaiian Kingdom by its Council of Regency."[31] Mr. Larsen's basic complaint was that the Hawaiian Kingdom had violated international law and its 1849 Treaty of Friendship, Commerce, and Navigation with the United States by allowing the "unlawful imposition of American municipal law" within Hawaiian territory – and in particular over Mr. Larsen's person.[32] Mr. Larsen was apparently particularly upset with this application of U.S. municipal law because it had caused him to go to jail, and also because he was facing some additional jail time on a second sentence.[33]

The parties in *Larsen* – that is, Mr. Larsen and the Hawaiian Kingdom – decided to construct a number of rules for the arbitration of their "dispute." For example, the parties agreed to bifurcate the case. In the first stage, the tribunal would need to decide the territorial sovereignty of the Hawaiian Kingdom. In the second stage, the tribunal would need to decide whether the Kingdom had violated Mr. Larsen's rights.[34]

However, the tribunal was unsympathetic to the parties' agreement to adopt case-specific rules. On February 5, 2001 – approximately ten months after being fully constituted and after holding the appropriate hearings at the Peace Palace in the Hague – the tribunal issued a 44-page award finding that the parties could not have the matter arbitrated as they had stipulated because the United States was, in effect, an indispensable party.[35]

The *Larsen* decision teaches that existing arbitration rules are not infinitely flexible. Although Mr. Larsen's counsel deserves great credit for creativity, in that particular arbitration creativity was insufficient to surmount reality. Notwithstanding the foregoing limitations, though, arbitration counsel that are willing to use some creativity and some aggression in seeking to construct favorable rules for each individual arbitration can obtain an advantage equal to or greater than that enjoyed by the trial lawyer who has mastered all of the procedural rules in litigation.

C. Ryan Reetz *is a shareholder, International Litigation Department, Greenberg Traurig, P.A., Miami, Florida, USA. E-mail: reetzr@gtlaw.com or ryan.reetz@post.harvard.edu .* *This article first appeared online in 2 Transnational Dispute Management No. 1 (Jan. 2005).*

Endnotes:

1 "Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage of the proceedings each party is given a full opportunity of presenting his case." *See also* Article 17(1), Arbitration Rules of the Commercial Arbitration and Mediation Center for the Americas; Article 12(1), Inter-American Commercial Arbitration Rules of Procedure.

2 Article 15(1), ICC Rules. As with the AAA and UNCITRAL Rules, the ICC Rules limit the arbitrator's discretion by imposing duties of fairness and impartiality, and by requiring that each party be given "a reasonable opportunity to present its case." Article 15(2).

3 *See, e.g.*, [Revised] Uniform Arbitration Act (U.L.A.) §15(a) (2000) ("An arbitrator may conduct an arbitration in such manner as the arbitrator considers appropriate for a fair and expeditious disposition of the proceeding.").

4 The AAA's International Arbitration Rules, for example, provide a very minimal disclosure threshold and leave additional discovery and disclosure to the arbitrator's discretion. Article 20(2) provides that "[a]t least 15 days before the hearing, each party shall give the tribunal and the other parties the names and addresses of any witnesses it intends to present, the subject of their testimony and the languages in which such witnesses will give their testimony." Articles 16(1), 17(1), and 19(2)-(3) provide authority for arbitrators to order additional discovery and disclosure if deemed appropriate. *See generally* G. Bernini, "The Civil Law Approach to Discovery: A Comparative Overview of the Taking of Evidence in the Anglo-American and Continental Arbitration

continued, next page

Systems", in L.W. Newman & R.D. Hill, THE LEADING ARBITRATORS' GUIDE TO INTERNATIONAL ARBITRATION (2003) at 269-305; C.N. Brower & J.K. Sharpe, "Determining the Extent of Discovery and Dealing With Requests for Discovery: Perspectives From the Common Law", in Newman and Hill, *supra*, at 307-45; B.M. Cremades, "Managing Discovery in International Arbitration", *Dispute Resolution Journal* (Nov. 2002 – Jan. 2003) at 72.

5 *See*, A. Redfern & M. Hunter, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION at ¶¶ 6-76 – 6-79 (3d ed. 1999).

6 *See, e.g.*, A. Redfern & M. Hunter, *supra*, at ¶¶ 6-81 – 6-89.

7 *See, e.g., Matter of the Arbitration Between Griffin Industries and Petrojam, Ltd.*, 1999 WL 543747 (S.D.N.Y. July 21, 1999) (upholding arbitral decision based solely on written submissions); *Matter of the Arbitration Between Intercarbon Bermuda and Caltex Trading*, 146 F.R.D. 64, 72-74 (S.D.N.Y. 1993) (similar holding; noting similarity to U.S. summary judgment procedure).

8 *See generally* CONSERVATORY AND PROVISIONAL MEASURES IN INTERNATIONAL ARBITRATION, ICC Publication No. 519 (1993).

9 The AAA's International Rules, ICC Rules, and UNCITRAL Rules all note that the "place [of the] arbitration" may be agreed by the parties. Article 13(1), AAA Int'l Rules; Article 14(1), ICC Rules; Article 16(1), UNCITRAL Rules. However, at least the AAA and UNCITRAL rules contain provisions that limit this principle. Article 13(2) of the AAA International Rules provides that "[t]he tribunal may hold conferences or hear witnesses or inspect property or documents at any place it deems appropriate." Similarly, Article 16 of the UNCITRAL Rules authorizes the arbitral tribunal to "hear witnesses and hold meetings for consultation among its members at any place it deems appropriate…" and further provides that the tribunal "may determine the locale of the arbitration within the country agreed upon by the parties" and "may meet at any place it deems appropriate for the inspection of goods, other property or documents." Article 14(2) of the ICC Rules appears to limit the tribunal's ability to "conduct hearings and meetings at any location it considers appropriate" to circumstances where the parties have not otherwise agreed – but, given the tribunal's power over the conduct and disposition of the parties' case, parties are often hard-pressed to maintain their opposition to a tribunal's suggestion of an alternative location.

10 The institutional rules require the arbitrators to apply the substantive law chosen by the parties. Article 28(1), AAA Int'l Rules (*but cf.* Article 28(2)); Article 17(1), ICC Rules (*but cf.* Article 17(2)); Article 33(1), UNCITRAL Rules (*but cf.* Article 33(3)). However, incautious drafting by the parties may result in unintended consequences. For example, many agreements containing arbitration clauses provide for the resolution of contractual claims according to the law of a chosen forum – but do not expressly address extracontractual claims (or claims based on additional transactions occurring after the

continued, next page

INTERNATIONAL LAW CERTIFICATION

The Board of Legal Specialization and Education
and
the International Law Certification Committee
are pleased to announce the following attorneys
are now Board Certified
as of June 1, 2005:

Congratulations!

Lawrence Allen Caplan – Boca Raton

Chandler Richards Finley – West Palm Beach

Antonio Maria Freire-Alvarez - Miami

Make It Your Goal Too!

Filing Period for March 10, 2006 Examination:
July 1, 2005 through August 31, 2005

Contact:

Carol Vaught
Legal Specialization and Education - The Florida Bar
(800)342-8060, ext. 5738 or (850)561-5738

or for further information go to:

www.FloridaBar.org / Member Services / Certification / International Law

contract that contains the arbitration clause). In addition, arbitrators may be persuaded to apply principles of *renvoi* so that the conflict-of-laws jurisprudence, rather than the substantive law, of the chosen jurisdiction is applied.

11 As with substantive law, the primary institutional rules implicitly require the arbitrators to respect the parties' agreement concerning the language of the proceeding. Article 14, AAA Int'l Rules; Article 16, ICC Rules; Article 17, UNCITRAL Rules. Nevertheless, the arbitration agreement's provision concerning language, if less than thoroughly drafted, may leave room for "interpretation" as to whether the language designation was intended to be exclusive and which aspects of the proceeding must be conducted in that language (*e.g.*, submissions, oral testimony, written testimony, documents). *See, e.g.*, Article 14, AAA Int'l Rules (tribunal *may* order that documents submitted in a different language be translated into language of the arbitration); *but cf.* Article 17(1), UNCITRAL Rules (arbitrators' determination of applicable language "shall apply to the statement of claim, the statement of defence, and any further written statements and, if oral hearings take place, to the language or languages used in them"). Moreover, the arbitral tribunal's overarching power over the conduct and result of the arbitration, coupled with the lack of traditional appellate remedies, creates substantial risks for a party that firmly resists a tribunal's strong "suggestion" that an additional or alternative language be used.

12 Article 16(2) of the AAA's International Rules contains only a short reference to the pre-hearing conference, noting that the tribunal "may conduct a preparatory conference … for the purpose of organizing, scheduling, and agreeing to procedures to expedite the subsequent proceedings." Rule R-20 of the AAA's Commercial Arbitration Rules discusses such conferences in greater detail, and states that "the parties and the arbitrator should discuss the future conduct of the case, including clarification of the issues and the claims, a schedule for the hearings, and any other preliminary matters." The ICC Rules are focused on the drawing up of the terms of reference, but clearly refer to the parties' participation in the process, and identify, as items to be included in the terms of reference, "unless the Arbitral Tribunal considers it inappropriate, a list of issues to be determined," and "particulars of the applicable procedural rules." Article 18. The ICC procedure also provides the opportunity to memorialize the rules in the terms of reference (which all parties and the arbitrators are supposed to sign). *Id*.

13 Not only do the institutional rules emphasize that the arbitrators' discretion is constrained by the requirement that parties be allowed fair opportunity to present their cases, Article 16(1), AAA Int'l Rules; Article 15(1), UNCITRAL Rules; Article 15(1), ICC Rules; one of the very few grounds for non-enforcement of an arbitral award under the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") is that the "party against whom the award was invoked was not given proper notice … of the arbitration proceedings *or was otherwise unable to present his case*…" New York Convention, Article V(1)(b) (emphasis added). *See also* Inter-American Convention on International Commercial Arbitration ("Panama Convention"), Article 5(1)(b) (award need not be recognized where "the party against which the arbitral decision has been made was not duly notified … of the arbitration procedure to be followed, or was *unable, for any other reason, to present his defense*…" (emphasis added); [U.S.] Federal Arbitration Act, 9 U.S.C. §10(a)(3) (domestic award may be vacated "where the arbitrators were guilty of misconduct … in refusing to hear evidence pertinent and material to the controversy…").

14 *See* W.L. Craig, W.W. Park, & J. Paulsson, International Chamber of Commerce Arbitration §23.01 at 417 (3d ed. 2000) ("as most ICC arbitrators are jurists, arbitrators act within a legal framework. They tend to apply procedures with which they are familiar and to look to the legal system which they know best, or is most closely connected to the dispute, in search of procedures to adopt by analogy.").

15 *See, e.g.*, Article 27(8), AAA Int'l Rules ("Unless otherwise agreed by the parties, the administrator may publish or otherwise make publicly available selected awards, decisions and rulings that have been edited to conceal the names of the parties and other identifying details or that have been made publicly available in the course of enforcement or otherwise.").

16 *E.g.*, W.L. Craig, W.W. Park., & J. Paulsson, *supra*; A. Redfern & M. Hunter, *supra*; Y. Derains & E.A. Schwartz, A Guide to the New ICC Rules of Arbitration (1998).

17 Article 16(1), AAA Int'l Rules; Article 15(2), ICC Rules; Article 15(1), UNCITRAL Rules.

18 Article 21, AAA Int'l Rules; Article 23(1), ICC Rules; Article 26, UNCITRAL Rules.

19 International Bar Association, *IBA Rules on the Taking of Evidence in International Commercial Arbitration* (1999).

20 Joint American Law Institute / UNIDROIT Working Group on Principles and Rules of Transnational Civil Procedure, *Principles of Transnational Civil Procedure* (2004). The principles (and their accompanying commentary) include discussion relevant to, *inter alia*, a party's having a "reasonable opportunity" to present its case (principle 3), due notice and the right to be heard (principle 5), provisional relief (principle 8), structure of the proceedings (principle 9), and discovery/disclosure (principle 16).

21 *See* item 8, *infra* (discussing Article V(1)(b) of the New York Convention and related authorities).

22 *Principles of Transnational Civil Procedure*, principles 3 ("Procedural Equality of the Parties"), 5 ("Due Notice and Right to be Heard") & accompanying comments

23 *See* Advisory Committee Notes to [U.S.] Fed.R.Evid. 407, 408.

24 *See* 8 J.H. Wigmore, Evidence in Trials at Common Law (J.T. McNaughton ed. 1961) §2291.

25 *See* 6 J.H. Wigmore, *supra*, §§1837-38 (invoking Biblical story of Susanna and the Elders).

26 *See* 3 J.H. Wigmore, *supra*, §769 (discussing leading questions).

27 The analogy is, of course, not an exact one. In the litigation context, courts typically follow their own procedural and evidentiary rules without engaging in a conflict-of-laws analysis, and the discretion conferred upon arbitrators by the institutional rules unambiguously frees them from the need to determine and apply a governing procedural and evidentiary law (subject to any limitations imposed by the *lex arbitri*). Nevertheless, the lines between procedure and substance are often blurred, as the U.S. courts have found in decades of judicial federalism decisions. *See, e.g., Gasperini v. Center for Humanities, Inc.*, 518 U.S. 415, 116 S. Ct. 2211 (1996); *Walker v. Armco Steel Corp.*, 446 U.S. 740, 100 S. Ct. 1978 (1980); *Hanna v. Plumer*, 380 U.S. 460, 85 S. Ct. 1136 (1965); *Byrd v. Blue Ridge Rural Electric Cooperative, Inc.*, 356 U.S. 525, 78 S. Ct. 893 (1958); *Guaranty Trust Co. v. York*, 326 U.S. 99, 65 S. Ct. 1464 (1945). The lines between evidence and substance are similarly blurred, as in the case of the "parol evidence rule," under which evidence of prior or contemporaneous oral agreements is inadmissible to vary or contradict the terms of a contract – and which is treated as a rule of substantive law in many jurisdictions. *See, e.g., Ungerleider v. Gordon*, 214 F.3d 1279, 1282 (11th Cir. 2000). Moreover, some procedural and evidentiary rules reflect policy determinations that are considered to have substantive importance by the jurisdictions that have adopted them: discovery-blocking statutes provide an arguable example. Given these considerations, an arbitral tribunal that is asked to adopt a rule following the practice of one related jurisdiction rather than the contrary practice of another may reasonably view the issue as similar to a conflict-of-laws analysis.

28 *Cf., e.g.*, M.M. Franckiewicz, "The Rules of Evidence and Labor Arbitration", *Dispute Resolution Journal* (Aug. – Oct. 2002) at 44 ("There is at least some chance that an arbitrator's decision may be reversed by a court for excluding relevant evidence, but essentially no chance that the decision will be reversed for admitting evidence that would not be admissible in a court proceeding. Accordingly, many arbitrators respond to evidentiary objections by making relevance the standard for the admission of evidence.").

29 *See* G.F. Phillips, "Is Creeping Legalism Infecting Arbitration?", *Dispute Resolution Journal* (Feb. – Apr. 2003) at 37 (discussing survey of arbitrators concerning increased formalism in arbitration).

30 A copy of the arbitral award ("Award") is available on the Internet at http://www.pca-cpa.org/PDF/LHKAward.pdf. An interesting collection of information concerning the case (including submissions and correspondence) is available at http://www.alohaquest.com/arbitration/index.htm.

31 Award, ¶¶ 1-2. More information concerning this entity is available at http://www.hawaiiankingdom.org.

32 Award, ¶ 2.1.

33 Award, ¶ 2.3.

34 Award, ¶ 2.1.

35 Award, ¶¶ 11.8 – 12.19 at pp. 29-42, 44.

Resolving Commercial Disputes – What Are the Options?

By Daniel E. González and Richard C. Lorenzo

Business owners expect their managers and lawyers to foresee, prevent and mitigate the risk of potential disputes arising between their companies and their counterparts in business transactions. The main dispute-preventive measures are, first, to provide a clear and effective set of contractual rights and obligations in the agreements governing the business relationship and, second, to achieve a balanced business result that benefits all parties involved in the relevant transaction. Effective negotiation and clear drafting will go a long way in achieving the former, while effective risk allocation – the contractual provisions laying responsibility for certain matters upon the party most able and/or willing to assume the relevant risks – will be crucial in achieving the latter.

If a disagreement arises among the parties by failure or in spite of the contractual arrangement of rights, obligations and risks, and if negotiations fail to solve that disagreement, the next line of defense is the resolution of the dispute through dispute resolution methods, which more often today are clearly delineated within the contractual agreement in dispute. The most common dispute resolution methods are litigation, arbitration, and mediation (also known as conciliation). Litigation is carried out by formal proceedings before the *courts* of a certain country and in accordance with the procedural laws of that country. Litigation will be the dispute resolution method by default if the parties do not agree to resort to some other method. Arbitration is conducted by one or more neutral third parties (called *arbitrators*), usually appointed by the disputing parties. Arbitrators will generally resolve the relevant dispute following the procedural rules elected by the parties. Mediation or conciliation is a method whereby a neutral third party (a *mediator*) attempts to help the disputing parties settle their differences. While the courts' decisions and arbitrators' awards are binding upon the parties, mediators issue recommendations that may be accepted or rejected by the parties – in other words, mediation can be described as a guided or brokered negotiation.

Which of these dispute resolution methods is most effective? At the outset, it is important to bear in mind that there is no straightforward answer to this question. The effectiveness of the dispute resolution mechanism will ultimately depend on issues such as the interests of the parties, the nature and amount of the transaction, the kind and significance of the disputes that may arise out of the business relationship, and the jurisdictions involved in the dispute. An effective dispute resolution mechanism will by and large be one narrowly tailored to those issues. This article attempts to provide some general guidelines for the choice of dispute resolution mechanisms in business transactions.

Litigation

Litigation has been the traditional method of solving commercial disputes, particularly where those disputes arise in the context of domestic business transactions or relationships. When the law governing those transactions or relationships is the law of a U.S. state or territory, having the disputes arising under the relevant agreements resolved by U.S. courts is likely to provide certainty as to the parties' rights and obligations, by ensuring the availability of a substantial body of case law interpreting those rights and obligations and the laws applicable to them. In addition, litigation will also provide a more direct enforcement of the relevant court decision if enforcement is sought in the U.S. – for example, when the losing party's assets are located in the U.S. The same is not true, however, in significant or complex cross-border transactions or relationships where, as further discussed below, international arbitration is generally preferred.

Among the most common charges against litigation are that it is too formalistic, rigid, invasive, confrontational, expensive and time-consuming in resolving many of today's business disputes. In general terms, these are fair accusations, particularly when the amounts or stakes involved in the dispute are not substantial, where a fast resolution is required for the success of a project or venture, or where the parties' best long-term interest would be to continue their business relationship. Because litigation is generally very adversarial and conducted through mandatory rules of procedure, normally courts lack the flexibility to shorten or adapt the various procedural stages, such as discovery, to suit the relevant dispute or the parties' interests. This rigid formality can make the dispute resolution process excessively slow, expensive and complex, and many times inadequate to the specific dispute. Overloaded courts and rights of appeal also contribute to the lengthiness of litigation. In addition, as a consequence of the legalistic and adversarial nature of litigation, a court will generally tend to focus more on the parties' *legal rights* – a right vs. wrong approach – than on their *business interests* – a decision between gain/convenience or loss/inconvenience – and it will thus have a propensity to render a win-lose solution to the dispute, sending the adverse parties their separate ways, instead of a win-win solution that could allow the parties to continue their business relationship. The divide between litigants is also deepened by the confrontational nature of litigation, which exacerbates the differences and intensifies the distrust between the parties.

Another common criticism of litigation is the fact that, because litigated disputes are usually in the public record, the parties are precluded from keeping their business conflicts private and confidential. In certain respects, however, publicity is or may be beneficial. For example, the threat of litigation may act as an incentive for parties who are fearful of negative publicity to perform their obliga-

tions more zealously, or for prospective defendants with that same fear to settle their disputes early and avoid a lawsuit. That said, most parties, if given the choice, would prefer to have their commercial disputes remain confidential. A fact that is difficult and in many instances impossible to achieve in the judicial litigation forum.

Arbitration

Parties submitting their business disputes to arbitration instead of litigation usually expect to get greater procedural flexibility, confidentiality, and speed. As opposed to litigation, where the parties have little or no choice as to what court or trier-of-fact will resolve their dispute or what procedural rules will govern the dispute resolution process, parties to arbitration are free to, among other things, (i) appoint the arbitrators by name or entrust that appointment to one of many arbitration institutions, (ii) choose between having the proceedings administered by one of many national or local arbitration institutions such as the American Arbitration Association or the chambers of commerce's arbitration panels in many large cities throughout the world (called *institutional* arbitration) or without any such administration (called *ad hoc* arbitration), (iii) choose the applicable substantive law and (iv) choose the procedural rules that will govern the arbitration, which may be the rules of a certain arbitration institution, the rules crafted by the parties, or a combination of both. This gives the parties the ability to customize the proceedings in accordance with the nature and amount of, and their interests in, the dispute. For instance, the parties may reduce the duration of hearings, limit discovery, have certain technical issues summarily and finally decided by an expert, or have certain disputes be subject to a document-only proceeding (*i.e.*, without witness testimony). Thus, when the various procedural options available to the parties are combined appropriately to suit the nature and stakes of the dispute and the interests of the parties, arbitration has the potential of being faster, more expedient and less costly than litigation.

In addition to procedural flexibility, arbitration provides the parties with a resolution of their dispute that is usually subject to limited appellate review. Although arbitral awards may be challenged under certain limited grounds, the lack of an automatic right of appeal usually reduces the time for final resolution of the dispute and the cost to the parties.

Another important difference between arbitration and litigation is that the former is a private matter – *i.e.*, it is not in the public record. In addition, the contents and even the existence of a dispute may be kept confidential, and so the parties may be protected against disclosure of such matters to any third parties without the non-disclosing party's consent. This is a significant advantage over litigation for many businesses that want to keep their business disputes private.

In the context of cross-border transactions and business relations, and in addition to the benefits mentioned above, arbitration has at least two important advantages over litigation. First, foreign parties to international transactions are often unwilling to accept a U.S. court as the dispute resolution venue in their contractual arrangements with U.S. counterparts. Likewise, U.S. parties will prefer to have a neutral third party rather than its foreign counterpart's national courts resolve their business disputes. In such scenarios, arbitration often provides a solution acceptable to both parties. Second, enforcing an arbitral award across boundaries is substantially easier than enforcing a court decision across boundaries. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which is ratified by more than 120 countries, provides for the recognition and enforcement of foreign arbitral awards in the countries that have ratified it. This affords a degree of international enforceability to arbitral awards that is not available to the decisions of national courts. As a consequence, parties to cross-border transactions that choose international arbitration as their dispute resolution method have a greater ability to enforce the final award, especially when the losing party's assets are located in countries other than the one where the arbitral award was rendered.

Some of the negative features of litigation are also applicable to arbitration. Like national courts, arbitrators will focus mostly on the parties' rights rather than their interests, and the proceedings will also tend to be highly adversarial and confrontational. This will generally result, like in litigation, in the parties' inability or unwillingness to continue their business relations after the dispute has been resolved. Arbitration costs can also be high, and in some cases even higher than litigation costs in the initial stages. Even where procedural rules are shortened and customized by the parties, the parties will have to pay certain costs that in litigation proceedings are usually borne by the state, such as arbitrators' fees, institutional fees, secretary fees, rental of arbitration hearing rooms, rental of equipment, etc. Some of these cost, however, are offset by the fact that the right of appeal is much more limited in arbitration, which is a cost certainly associated with litigation.

Finally, arbitration can also prove to be time-consuming and inappropriate for certain types of disputes and business relationships, particularly when it is not preceded by mediation or other alternative dispute resolution methods. Such is the case, for example, of smaller disputes arising in large construction projects where the parties' best interest is to resolve those disputes quickly and reach a mutually beneficial solution in order to finish construction on schedule, as opposed to entering into a highly time-consuming and adversarial arbitration mode that will take their focus away from the project and harm their ability to continue their relationship beyond the arbitral award.

Mediation

In general terms, mediation is the most informal and flexible dispute resolution mechanism. The mediator is not constrained by the legal, *rights-based* approach that restricts courts and arbitrators, and the parties have almost absolute control over the procedural aspects of the mediation process. The nature of the mediation process, where the mediator meets individually with each party and tries to close the divide between them, tends to promote a dynamic flow of certain information – such as the parties' economic bottom-line

continued, next page

(known as "shuttle diplomacy") or the emotional elements of the dispute – which would almost never surface in adversarial processes such as litigation and arbitration. These characteristics allow for a more *interest-based* resolution of the dispute and tend to promote the continuity of the parties' business relations. For example, a mediator may help the parties realize that the essence of the dispute is based on a misallocation of the risks of their common venture, and thus a mere amendment to the relevant agreements that reallocates the parties' risks may resolve the dispute. Solutions like this one are highly unlikely within a litigation or arbitration proceeding. In addition, the costs associated with mediation are much lower than litigation or arbitration costs and, because the parties control the mediation schedule, the time spent in mediation is generally also shorter. Like arbitration, mediation is also a private matter that can be subject to strict confidentiality.

The most salient disadvantage of mediation, however, is that it is not final or binding. Either party may put an end to a mediation proceeding unilaterally at any time, and the solution proposed by the mediator will only be effective and final if the parties agree to it through the execution of a legally binding agreement. Because of this, parties usually choose mediation as a dispute resolution mechanism that precedes a binding resolution mechanism. If mediation does not resolve the dispute, the parties will resort to arbitration or litigation. This phased dispute resolution design is even mandatory in certain jurisdictions, such as Argentina, where the parties are required by law to submit certain disputes to mediation as a prerequisite to filing a lawsuit.

Conclusion and Summary

This cursory review of the main characteristics and various advantages and disadvantages of the three main dispute resolution methods leads us to conclude that there is no precise answer to the question of which dispute resolution method is most effective. Like a tailor fitted suit, the specific circumstances of the parties, the nature of the business relations and the significance and type of disputes will determine the most customized dispute resolution mechanism. In addition, the two binding mechanisms (litigation and arbitration) are not necessarily exclusive of, and in fact are commonly used in combination with, mediation.

The following table provides a summary of the main features discussed above, and rates such features from one to three – one being the *highest* rating for the relevant feature and three being the *lowest*.

Daniel E. González *is a partner at the international law firm of Hogan & Hartson L.L.P. and the Chairman of the firm's International Litigation and Arbitration Practice Group. Richard C. Lorenzo is a partner at Hogan & Hartson L.L.P. and a member of the firm's International Litigation and Arbitration Practice Group.*

Feature	Litigation	Arbitration	Mediation
Binding effect of the resolution	1	1	3
Final effect of the resolution	2	1	3
Domestic enforceability of the resolution	1	1	3
Cross-border enforceability of the resolution	2	1	3
Speed	3	2	1
Confidentiality	3	2	1
Cost	3	2-3	1
Neutrality in domestic disputes	1	1	1
Perceived neutrality in international disputes	3	1	1
Flexibility / adaptability to specific nature of the dispute and parties' business goals	3	2	1
Consideration of the parties' business *interests*	3	2	1
Consideration of the parties' *legal rights*	1	1	2

PERM: *Friend or Foe*?

By Deirdre D. Nero, Esq. and Philip Guo, Esq.*

PERM...it isn't just for hair anymore! Nowadays when you hear the term "PERM" (especially if you are among a group of foreigners, business owners, or lawyers), what they are likely referring to is **P**rogram **E**lectronic **R**eview **M**anagement, the new electronic method of submitting a Labor Certification application for the permanent employment of a foreign worker. Labor Certification is the first step in obtaining a Greencard based on employment, and has been around in various incarnations for many years.

The PERM system, which made it's debut on March 28, 2005, was created to enact new rules promulgated by the Department of Labor (DOL) in December of last year. PERM signifies the beginning of a new era in Immigration Law as yet another once paper heavy process turns high-tech. Internet and computer savvy people of the world rejoice! As for everyone else... well, that's another story.

There are many skeptics in the legal community who are bemoaning the *virtual* shortcomings of this new system and methodology, which is not beyond reason considering the infamous reputation of the Labor Certification process and the Immigration service as a whole. But PERM is not without its fans, the authors being two of them, who are cautiously optimistic for the promised speed and ease that the PERM system is designed to provide. In fact, the DOL was so bold as to promise decisions on PERM applications in 60-90 days! "Impossible!" cried the immigration lawyers, "a Labor Certification under the old system took *years*."

As immigration lawyers around the country with enough courage to brave the new electronic frontier of PERM began filing the applications, horror stories of automatic denials spread like wildfire. The community waited....and waited. Nobody heard anything about approvals, just denial after denial after denial. But then, on May 23, 2005, the impossible happened! The approvals began to arrive in the anxious (and perhaps nervously sweaty) hands of the lawyers. It was true! An approved Labor Certification in 60-90 days!

The authors will let you in on a secret. It is all in the careful and meticulous preparation of the online application. Not only must you know how to work a computer with sufficient ease, but you must be sure that all the requirements for the pre-filing recruitment of potential U.S. workers is done in the exact manner prescribed in the new law. We set out to conquer this new system and take it apart from top to bottom so we could then put everything together in the correct order and formulation. We dissected, poked, prodded, and prepared trial runs on the system to learn it well before anything was at stake when we clicked the mouse.

After this preparation, all we needed was a client brave enough to be our guinea pig in this PERM experiment. Luckily, one such individual (who has since been followed by dozens of others) stepped forward. With the help of a cooperative and computer literate employer, both of which are essential to the PERM process, we embarked on the unknown. We waited...and on June 1, 2005 the PERM was approved! Ours became one of the first in the state of Florida and the entire country to be approved, and now after only 2 months of suspense, our brave client can immediately begin the process of applying for her Greencard.

This new process is not without its problems, among the most glaring is the need for the employer to be computer savvy, which seems like an odd new form of discrimination. Nonetheless, the program is very promising and likely to improve as the technical glitches get ironed out. In fact some of the early problems have already been identified and either fixed or explained to users.

Like it or not, PERM is here to stay. Maybe those computer classes you have been meaning to enroll in for the last three years are finally going to be necessary.

Deirdre D. Nero, Esq. *and* ***Philip Guo, Esq.*** *are immigration attorneys at the law firm of Becker & Poliakoff, P.A. in Fort Lauderdale and Coral Gables, Florida. Deirdre Nero can be reached at dnero@becker-poliakoff.com or (305)351-1079, and Philip Guo can be reached at pguo@becker-poliakoff.com or (954) 965-5052.*

Technology Committee:

Status Report on the Section Website Project

Since our last report, the International Law Section awarded the website contract to Elliot Zimmerman, Esq., the designer of the website for the Entertainment, Arts and Sports Law Section. The key feature behind the Section's decision was the promise of a dynamic and interactive site that would be updated and maintained by the Section itself, eliminating the need for costly intermediaries and providing the Section with a greater independence in cultivating its image.

The website contract was negotiated and signed and work on the new site has begun. The Section's new web address will be: **www.internationallawsection.org**

Some of the newer features to be seen on the new website shall include:

- An interactive calendar of Section functions
- Online membership subscriptions to join the Section
- Password-protected areas reserved for Section members only
- Listserv mailing lists
- Archives of Section materials
- A regularly updated photo gallery
- Extensive links to websites of interest to the International Lawyer

The Committee anticipates having substantial completion of the website (including listserv mailing lists) achieved by the Section's Annual Meeting in Orlando on June 24th.

The Committee seeks written and photographic contributions from the Section members. Please contact Section Administrator, Angela Froelich, at afroelic@flabar.org or Committee Chair Francisco Corrales at fcorrales@glantzlaw.com for more information.

INTERNATIONAL LAW SECTION STATEMENT OF OPERATION

Revenue	2004-05 Approved Budget	Year End June 2005 Actuals	2005-06 Approved Budget
Dues	25,000	23,550	25,000
Affiliate Dues	875	1,010	875
Less Retained by TFB	(13,000)	(12,392)	(13,000)
Total Dues	**12,875**	**12,168**	**12,875**
Course Income	22,500	33,215	22,500
Videotape Sales	300	0	0
Audiotape Sales	2,000	3,719	2,000
Book/Material Sales	1,000	241	1,000
Newsletter Subscriptions	1,000	250	0
Advertising Revenue	650	0	2,500
Members Service Program	5,000	51,508	11,000
Foreign Programs	75,000	0	50,000
Sponsorship	1,000	1,000	1,000
Investment Income	8,058	5,613	11,188
Miscellaneous	2,500	(212)	2,500
Credit Card Fees	(100)	(203)	(50)
Total Revenues	**131,783**	**107,299**	**116,013**
Expenses			
Staff Travel	4,860	3,253	3,342
Postage	4,115	1,506	2,550
Printing	650	182	750
Officer/Council Office Expense	300	0	0
Newsletter	4,500	68	500
Membership	2,500	0	2,500
Supplies	250	118	250
Photocopying	700	177	700
Officer Travel Expense	1,000	0	1,000
Meeting Travel Expense	1,500	253	1,500
Out of State Travel	15,000	0	2,500
CLE Speaker Expense	5,000	6,157	5,000
Committee Expense	2,500	3,011	2,500
Board or Council Meeting	1,500	193	1,500
Bar Annual Meeting	8,000	3,812	8,000
Midyear Meeting	5,000	12,794	5,000
General Meeting	2,500	0	2,500
Section Service Program	2,500	4,448	2,500
Foreign Program Expenses	53,500	55,647	50,000
Section Retreat	10,000	10,239	3,000
Section Membership Directory	7,500	0	500
Awards	5,000	2,972	2,500
Vause Writing Contest	2,000	0	2,000
Intl Arb Pre-Comp	0	11,420	10,000
Case Law Digest	0	2,775	2,500
Lobbying	0	0	16,000
Website	10,000	8,600	2,500
Council of Sections	300	300	300
Miscellaneous	1,000	43	1,000
CLER Credit Fee	150	150	150
Special Projects	500	5,176	2,500
Operating Reserve	15,233	0	15,304
Total Expenses	**167,558**	**133,144**	**151,846**
Beginning Fund Balance	**167,203**	**134,110**	**159,824**
Net Operations	**(35,775)**	**(25,845)**	**(35,833)**
Ending Fund Balance	**131,428**	**108,265**	**123,991**

SECTION REIMBURSEMENT POLICIES: General: All travel and office expense payments in accordance with Standing Board Policy 5.61. Travel expenses for other than Bar staff may be made if in accordance with SBP 5.61(e)(5)(a)-(i) and 5.61 (e)(6) which is available from Bar headquarters upon request.

Sarfati, 691 So. 2d 5 (Fla. 3d DCA 1997), and *Benedict v. Pensacola Motor Sales, Inc.*, 846 So. 2d 1238 (Fla. 1st DCA 2003), the courts held that there was a requirement for proof of prejudice for there to be a waiver sufficient to deny arbitration.

In the Second District's opinion below, *Raymond James Fin. Servs. v. Saldukas*, 851 So. 2d 853 (Fla. 2nd DCA 2003), its holding was consistent with *Owens & Minor Med., Inc. v. Innovative Mktg. & Distrib. Servs., Inc.*, 71 So. 2d 176 (Fla. 4th DCA 1998) and *Morrell v. Wyne Fryer Manufactured Home Center*, 834 So. 2d 395 (Fla. 5th DCA 2003) in finding that proof of prejudice was not required.

The Florida Supreme Court commented also on the similar conflict that exists federally, with the District of Columbia and Seventh Circuits finding that waiver may be found absent a showing of prejudice, but the Eleventh Circuit requiring prejudice for effective waiver of an arbitration provision. Further, given that the United States Supreme Court has not decided the issue, Florida's state courts are free to interpret the Federal Arbitration Act as being consistent with Florida decisions analyzing the issue under the Florida Arbitration Code.

In the instant case, a New York Stock Exchange arbitral proceeding had initially been brought wherein Raymond James took the position in both a letter to counsel and a motion that it had "no obligation to arbitrate this case" and would "file a lawsuit to enjoin the arbitration" were it not dismissed. *Raymond James Fin. Servs.*, 30 Fla. L. Weekly at S115. When the claimants then proceeded instead to file a Florida state-court action, Raymond James moved to compel arbitration and, for the first time, argued that the decision as to whether one of the plaintiffs was a proper party should be determined by the arbitrators. *Id.* The Second District Court of Appeal upheld the trial judge's decision that "by repeatedly asserting that [the claimants] had no right to arbitrate, and by threatening a lawsuit to enjoin arbitration" Raymond James had waived its right to arbitrate. The Second District held that the appellees were not required to show prejudice in order for the trial court to deny the motion to compel arbitration, and it certified the conflict. *See generally Raymond James Fin. Servs.*, 851 So. 2d 853 (Fla. 2nd DCA 2003),

The Florida Supreme Court analyzed the issue by remarking that "[a]rbitration is a valuable right . . . [that] must be safeguarded by a party who seeks to rely upon that right . . . ." *Id.* The issue of whether there has a been waiver in the arbitration-agreement context should be analyzed in much the same way as in any other contractual context: "'[t]he essential question is whether, under the totality of circumstances, the defaulting party has acted inconsistently with the arbitration right.'" *Raymond James Fin. Servs.*, 30 Fla. L. Weekly at S116, quoting *National Found. for Cancer Research v. A.G. Edwards & Sons, Inc.*, 821 F.2d 772, 774 (D.C. Cir. 1987).

The court held here, that having acted inconsistently with the arbitration provision, Raymond James had committed conduct that "vontar[ily] and intentional[ly] relinquish[ed] a known right," the only standard previously enunciated for contractual waiver by the Florida Supreme Court; and no showing prejudice was necessary. *Id.*

Thus, in approving the Second District's holding, and disapproving the First and Third Districts' previous decisions, the Florida Supreme Court provides a modicum of assistance to parties seeking to escape their contractual obligations to arbitrate.

Richard Lorenzo *and* ***Alvin Lindsay*** *are partners in the Miami, Florida office of Hogan & Hartson L.L.P. where they specialize in the domestic and international arbitration of complex commercial disputes.*

The Florida Bar
651 East Jefferson Street
Tallahassee, FL 32399-2300

FIRST CLASS
U.S. POSTAGE
PAID
TALLAHASSEE, FL
Permit No. 43