North American

WorldTrade Executive, Inc.

Free Trade & Investment Report

Biweekly report on legal & financial issues affecting direct investment and cross-border trade in Mexico, the U.S., and Canada

United States: Trade

Issue in Focus: The Elections, the 110th, and Trade

By Eric Shimp (Alston & Bird LLP)

We'll find ways to involve more members on issues like trade policy so we can show the American people that expanded trade doesn't always have to mean the loss of good paying jobs here at home. – Prospective Ways & Means Chairman Charlie Rangel (D-NY), November 8th

I would renegotiate NAFTA, as I would renegotiate PNTR with China... I think we're going to see major trade fights in both houses. – Senator-elect Sherrod Brown (D-OH), October 1st on Meet the Press...and at November 8th press conference

As a result of the U.S. mid-term elections, the next two years present significant political challenges for foreign economic policy.

See ***Trade****, page 15*➢

Mexico: Antitrust

Analysis of Recent Changes to Mexican Competition Law

By Alejandro López-Velarde (López Velarde, Heftye y Soria, S.C.) and Regina Kuchle (AstraZeneca)

Editor's Note: This is part one of a two-part article. Part two will appear in the November 30, 2006 issue of *NAFTIR*.

After nine months of negotiations with the participation of the OCDE, entrepreneurs and the Board Coordinator Entrepreneur (*Consejo Coordinador Empresarial*), the Mexican Congress approved and enacted anticipated reforms to the Mexican Federal Competition Law (*Ley Federal de Competencia Economica* - hereinafter cited as the "Antitrust Law"), published in the Official Gazette of the Federation (*Diario Official de la Federacion*) on June 28, 2006.

See ***Mexico****, page 4*➢

HIGHLIGHTS

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MEXICO

Customs

Customs Transmittal Fee Declared Unconstitutional

By Rene Cacheaux and Miriam Name
(Cacheaux, Cavazos & Newton, L.L.P.)

As part of the package of legislative reforms in the fiscal area enacted for the 2005 calendar year, the section of the Mexican Federal Law of Fees (*Ley Federal de Derechos*) (the "Law") relating to Customs Transmittal Fees ("DTA") was amended to include the levy of a percentage or a fixed sum on all importations made by any importer into Mexico. This additional payment applies also to customs entries that are exempt from general importation duties according to the terms of the Customs Law (*Ley Aduanera)*, which is to say temporary importations, products originating from NAFTA countries, and other countries with which Mexico has entered into free trade agreements.

As for frequent importers, this payment represents an important additional cost that will surely affect the cost of their business operations in Mexico.

Collection of the DTA as described above violates legal provisions contained in Mexico's Constitution; consequently, several importers filed a special lawsuit (*amparo*) protesting the new charge. Most of the cases were resolved in favor of the importer, at least for sections of the Law which refer to a DTA equivalent to the percentages applicable to the value of the imports. As such, it is important to note that the issuance of a favorable resolution for all such importers will benefit only those companies that have individually filed *amparos* protesting the tax.

Unfortunately, at the same time the Supreme Court issued favorable resolutions regarding the unconstitutionality of the DTA, a new opinion of the Court limited the benefits contained in the judgments granted to the contesting companies. Such new opinion states that in accordance with rule 1.3.5 of the Foreign Commerce Regulations, only 8% of the full 100% amount of the DTA is strictly considered as DTA, while the remaining 92% corresponds to a service paid to concessionaires hired by the Mexican government to process the corresponding customs documents. For example, if an importer paid $100,000 of DTA and filed an action protesting the DTA, such importer will be entitled to receive a reimbursement of only $8,000.

Rule 1.3.5 mentioned above is by its own nature unconstitutional, and its adoption by the Supreme Court in its jurisprudence opinion of the DTA had a tremendous impact on the otherwise favorable *amparo* rulings. The underlying reason for the enactment of Rule 1.3.5, issued several months after the DTA amendments, was to protect private companies hired by the *Servicio de Administración Tributaria* of the Treasury Department for electronic customs processing. Consequently, though the Courts had determined the DTA was evidently unconstitutional, granting the full benefits of the *amparo* by reimbursing the amounts of DTA paid by the importers who filed such special lawsuits, the result would have made it impossible for the Treasury Department to reimburse the millions of pesos paid by the importers and at the same time continue paying the private companies for the services for which they were hired.

This certainly appears to be a case where politics and other non-judicial reasons are being used by the Supreme Court to the detriment of the rule of law.

Notwithstanding the above, all importers should seek relief in all cases under the provisions of rule 5.1.3 of the Foreign Commerce Regulations currently in effect, which excuse from the payment of DTA importations of merchandise originating from a country with which Mexico has executed a tree trade agreement, thereby being able to avoid the payment of DTA in such cases.

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➢**Mexico,** *from page 1*

With the purpose of meeting the current standards of homologized antitrust legislation in an environment of globalization, and in order to have Mexico compete successfully in the new industrial and market challenges, the reforms address the great amount of loopholes found in the Antitrust Law by means of (i) modifying 25 Articles; (ii) adding 11 Articles; and (iii) repealing 1 Article.

As part of this policy of providing better legal tools and venues to protect competition and free access to the market, the Mexican government decided to grant more faculties and broader authorities to the Federal Competition Commission (*Comisión Federal de Competencia*—hereinafter cited as the "Antitrust Commission"), and to improve the efficiency and transparency of the investigation and proceeding of such restrictive practices and concentrations.

The Antitrust Law is a stringent public policy-based law, which cannot be avoided by economic agents dealing within any economic sector in Mexico.[1] The most important reforms recently enacted are the following:

Economic Agents

During the thirteen years of experience of the Antitrust Commission, several lawsuits have been filed with the Mexican Courts contesting its resolutions and calling for the inapplicability of the Antitrust Law, grounded on the claim that several entities without lucrative business purposes could not be found to be acting as economic agents subject to antitrust legislation. As a result of these frivolous lawsuits that allowed non-lucrative economic agents to escape from the applicability of the Antitrust Law, Article 3 was added in its text to enforce the compliance of all individuals and entities, regardless of whether their purpose is lucrative or not, such as commercial chambers and associations. Consequently, Article 3 now reads as follows:

> "ARTICLE 3.- All economic agents are subject to the provisions of this law, whether individuals or corporations with or without lucrative purposes, agencies or entities of the federal, state of local administration, associations, corporate chambers, professional groups, trusts or any other form of participation in economic activities."

Monopolies Under the Law

Throughout the last century and the beginning of the current one, Mexican foreign investment policy has carefully limited both foreign and domestic private investment within certain economic sectors that have had a political, historical and/or an economical significance for the Mexican nation. Industries such as oil, gas, petrochemical, power generation, spectrum and transportation all fit into this category. During the last two decades, however, Mexican policy has responded to sustainable economic growth and national development by adopting a more open approach to private investment within these key sectors, which were previously subject to substantial restrictions.

Article 28 Sections (IV) and (VII) of the Mexican Constitution lays out the so-called *strategic areas* that are exclusively reserved to the State, representing the most resistant areas to a free market liberalization. Moreover, the Constitution and the Foreign Investment Law dictate that additional activities set forth in the laws enacted by Congress should also be considered strategic areas.[2] Some of these economic activities include power generation, nuclear electricity, basic petrochemical, oil and gas, etc.

With the purpose of clarifying the Antitrust Law's scope of applicability, the referred amendments expressly state that acts which are not expressly considered as realized within the strategic sectors defined in Article 28 of the Mexican Constitution are subject to scrutiny of the Antitrust Law.

Additionally, the new Antitrust Law ratifies within its Article 5 that no labor unions, nor any temporary privileges or rights granted to authors, artists, inventors and individuals perfecting an improvement to use or exploit exclusively their works and/or inventions, will be considered as constituting monopolies. However, new Article 5 of the Antitrust Law provides that these entities or individuals are not exempted from the Antitrust Law when their acts do not constitute, nor are not related to, strategic markets expressly considered as legal monopolies[3] by such Constitutional Article 28.

Maximum Prices

The modifications to the Antitrust Law now dictate that the Federal Executive shall be exclusively responsible for determining, by means of expedited decrees, which goods and services shall be subject to maximum prices when essential to the Mexican economy, as long as no effective competition conditions exist within certain relevant markets whereby such price fixes will be imposed. In this sense, the Antitrust Commission shall be the authority in passing the resolution by which it will govern the effective competition conditions.[4]

Gains in Efficiency

Without a doubt, one of the most important modifications to the Antitrust Law is the express inclusion of gains in efficiency, a key factor of evaluation for which the Antitrust Commission has the obligation to take into account relative to monopolistic practices and concentration concerns. For more legal certainty and clarity, such obligation has been extracted from Article 6 of the Antitrust Law Regulations and is to be addressed in Article 10 of the Antitrust Law.

Pursuant to the Antitrust Law, such gains in efficiency are deemed to include economies of scale, network and scope; introduction of new products; favorable balances, defect or perishable goods; significant reduction in administrative costs due to improved production methods; introduction of improved or new goods or services due to new or improved technology; productive assets combination, investments and their recovery that improve quality in services or goods; distribution and supply networking; transfer of production and technology and reduction in production or costs stemming from an expansion in infrastructure or in the distribution network.

The concept of "economic efficiency" refers to the idea that no agent may improve its situation by negatively affecting the situation of another. Therefore, for a combination to generate an increase in economic efficiency, the reduction in company costs is not a sufficient condition. There needs to be an increase in the social surplus, understood as the sum of the surpluses of the various groups.

The above-mentioned significance of gains in efficiency has been addressed by the Antitrust Commission in the 2000 case against *Yakult, S.A. de C.V.* (Yakult), for restrictions on the resale price and denial of treatment regarding the fermented dairy product known as Yakult. Based on the previous provisions established in Article 6 of the Antitrust Regulations, the Antitrust Commission ruled that there were no elements to prove the existence of wrongful practices in the market of *Yakult*-type fermented dairy products, nor could Yakult be found responsible for committing the imposition of resale prices and denying treatment, although it was determined that Yakult was an agent with substantial power.

Because Yakult has a sales system through four distribution channels (i) independent distributors, (ii) exclusive agents, (iii) supermarkets and (iv) creameries, Yakult uses a price policy that favors independent distributors and that provides the suggested consumer sale price to all distributors. The other distributors did not abide by the suggested price, and therefore Yakult ceased to supply it with the product and denied treatment. Yakult did confirm that it ceased supply. However, it lessened the charge by demonstrating that it did not have substantial power; thus, it did not create any significant barriers to access the relevant market due to several factors. One such factor was Yakult's price policy, which was grounded on the idea that its independent distribution channel generated efficiency, consisting of cost reductions that benefited the distributors, the company and the end consumer. Yakult also demonstrated that it created gains in efficiency such as introduction of new services for a better distribution and supply networking; and reduction in service costs stemming from an expansion in infrastructure or in the distribution network. Based on the consideration that independent distributors generated the majority of their sales, it was established that such distributors did not enjoy credits, did not have the possibility of returning the product and offered fresher products at the home of the end consumer in the quantity the consumer required.

One of the most important modifications to the Antitrust Law is the express inclusion of gains in efficiency for which the Antitrust Commission has the obligation to take into account.

Likewise, Yakult demonstrated that its sales to supermarkets caused it to incur distribution and advertising costs, product returns and financial costs stemming from the credit of 30 to 45 days that was granted to self-service chains for payment of the product. Such differences make the price at which the product is sold to self-service stores higher than the price at which it is sold to independent distributors. Yakult demonstrated that the other distributors would not bring significant benefits to consumers nor to the process of competition by selling at a price lower than the suggested, but rather that its failure could cause the disappearance of its most efficient distribution channel, and consequently, that the gains in efficiency attributable to the independent distributors would not take place.

Likewise, the Antitrust Commission reiterated that, despite the fact that Yakult had a distribution channel different from its competitors, the channel was not considered to be a barrier. This is in view of the fact that any economic agent can create a distribution system that is the same or even more efficient than independent distributors, as long as efficiency in gains are proven to the Antitrust Commission.

Relative Monopolistic Practices, Horizontal Mergers

Efficiency gains attributable to a horizontal merger constitute a relevant aspect of the present-day antitrust public policy. Roller and Verboven (1999) discuss this aspect extensively and underscore that there is a recent debate underway among antitrust authorities in the United States and the European Union for the purpose of giving efficiency gains a more specific treatment in their respective laws.

Concentrations

Many of the world's authorities on antitrust have restated efficiency gains in concentrations and have included it as a material factor that plays out in favor of the companies involved in a concentration. The United States amended its law at the end of 1986 to include the criteria of efficiency gains in the analysis of mergers and monopolistic practices. However, the most telling example is Canada, whose antitrust legislation explicitly adopts the concept of efficiency gains and regulates its implementation with clarity.

The Antitrust Law allows most vertical agreements among non-competitors.

In the past, Mexican legislation did not leave out the possibility of a merger generating gains in efficiency; at times it is less than clear and suffers from a lack of specific evaluation criteria to corroborate the existence or lack of such gains. United States merger guidelines require companies to demonstrate the efficiency gains derived from the merger. On the other hand, Canadian law affords it a more specific treatment, since it literally adopts the efficiency approach of Williamson (1968). This author supports the *total welfare* approach to merger analysis and proposes comparing the *loss of economic efficiency* due to the increase in price after the merger, to the *internal efficiencies* generated. Williamson concludes that the cost savings can be very important in the overall effect of the merger: High production costs can be replaced by low production costs.

Relative Monopolistic Practices

The Antitrust Law allows most vertical agreements among non-competitors (e.g., manufacturers and distributors, commissioners or agents), except those made by a dominant firm for the purpose of unfairly driving its competitors from the market. Accordingly, the Antitrust Law allows exclusive clauses as long as such clauses do not have the purpose, effect or the result of wrongfully displacing other agents (e.g., producers or manufacturers with agents or commissioners) from the market, substantially impeding their access thereto or establishing exclusive advantages in favor of one or several entities by:

(i) vertical allocation of markets;[5]
(ii) restrictions on sale and price maintenance;[6]
(iii) tying agreements;[7]
(iv) entering into exclusive dealings;[8]
(v) unilaterally refusing to deal;[9] and
(vi) engaging in boycotts.[10]

The recent amendments to the Antitrust Law have added the following practices as constituting monopolistic practices as well:

(i) Predatory pricing.- This anticompetitive practice was previously established in Article 10 of the Antitrust Law as follows:

> *"...in general, engaging in any act that unduly impairs or impedes competition and free participation in the production, processing, distribution and marketing of goods and services."*

The Mexican Supreme Court declared this provision to be unconstitutional, ruling that it violates the legality and certainty principles pursuant to Article 16 of the Constitution, given that its wording did not identify particularly any action or practice which should be considered as a relative monopolistic practice sanctioned by the Antitrust Law.

(ii) Exclusive discounts.
(iii) Cross subsidies.
(iv) Discrimination on price and sale conditions.
(v) Increase of the costs and the possibility to impid the production process or reduction of demand to competitors.[11]

Part of the above-mentioned new monopolistic practices was previously established in Article 7 of the Antitrust Law Regulations. Consequently, several constitutional controversies were raised in which it was alleged that it was in the Antitrust Law that such assumptions needed to be enlisted, and not on a regulatory ordinance of the Law itself. Therefore, the amendments technically extracted complete secondary Article 7 to be adopted in Article 10 of the Antitrust Law.

From a legal point of view, the validity of establishing relative monopolistic practices in the Antitrust Law Regulations, which is issued by the Federal Executive, has been disputed on the grounds that, according to our state of law, such practices must be addressed by the Antitrust law enacted by the Congress of the Union in order to comply with the legal principle that implies that no regulatory provision issued by the Executive branch can go beyond the rulings of a law itself.

With regard to the referred disputes, pursuant to our Constitution, the President of Mexico is the only one empowered to decide upon the exact observance of a law at the administrative scope. However, the Federal Executive, through the Antitrust Law Regulations, has not only decided upon the observance of the Antitrust Law, but, as argued in the aforementioned disputes, has acted beyond those powers, converting itself into a virtual legislator that has exercised authorities that are only under the jurisdiction of the Mexican Congress.[12]

In addition to the inclusion of the above-mentioned relative monopolistic practice, it is established that the Antitrust Commission shall analyze the efficiency gains to consider if such practices shall be sanctioned pursuant to the Antitrust Law.

Interstate Market

Pursuant to the regulation applicable to state and municipality authorities in connection with the prohibition of entry or exit of goods or services from state territories, Article 14 was modified and Article 15 was abrogated in order to establish that the Antitrust Commission might issue a resolution when it considers that state or municipal authorities have issued legal ordinances or executed acts with the purpose or effect of impeding the entry or exit of goods or services, establishing tariff, taxes or any other kind of payment as established in Article 117 of the Mexican Constitution.[13]

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1 See *Ley Federal de Competencia Económica* (the "Antitrust Law"), arts. 1-3.

2 The promotion of foreign investment is not established in the Mexican Constitution. The Constitution grants no preferential rights to foreigners, taking a defensive position regarding foreigners. See Ignacio Gómez Palacio. *The New Regulation on Foreign Investment in México: A Difficult Task,* 12 Hous. J. Int'l L. 253. 255 – 256 (1990). See also *Constitución Política de los Estados Unidos Mexicanos* (the "Constitution"), arts. 27(I). 28, 32.

3 See Antitrust Law, Arts. 5-6.

4 Id. Art. 7.

5 This concept is understood as those agreements between economic agents that do not compete with one another, the fixing, imposition or establishment of exclusive distribution of goods or services, by reason of a certain entity, geographic location or period of time, including the division, distribution or assignment of customers or suppliers, as well as the imposition of the obligation to not manufacture or distribute goods or render services for a certain period of time or a period of time subject to determination. Id. Art. 10 (I).

6 This can be further defined as the imposition of a price or other conditions which a distributor or supplier must comply with when selling or distributing goods or offering services. Id. Art. 10 (II).

7 A tying agreement is understood as the sale or transaction contingent on the purchase, acquisition, sale or supply of another additional normally different or distinguishable product or service, or on the basis of reciprocity. Id. Art. 10 (III).

8 An exclusive dealing is understood as the sale or transaction contingent on not using or acquiring, selling or providing the goods or services produced, processed, distributed or marketed by a third party. Id. Art. 10 (IV).

9 Pursuant to the Antitrust Law a unilateral refusal to deal is a unilateral action consisting of refusing to sell or supply certain agents with available goods or services, normally offered to third parties. Id. Art. 10 (V).

10 It is the agreement between several economic agents or an invitation extended to them to exert pressure on a certain customer or supplier, for the purpose of dissuading it from a certain practice, to retaliate or force it to act in a certain manner. Id. Art. 10 (VI).

11 Id. Art. 10. In order to determine whether a relative monopolistic practice or a non-solicitation, non-competition or other exclusivity clauses could be illegal under the terms of the Antitrust Law, it is necessary to analyze whether or not the economic agents participating in the transaction will exert "substantial power" in the relevant market. Id. Arts.12-13.

12 See Constitution, art. 89 (I).

13 See Antitrust Law, Arts. 14-15.

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CANADA

Taxation

Tax Treaty Trumps Anti-Avoidance Rule

Treaty Shopping Does Not Trigger GAAR

By John Wonfor (BDO Dunwoody)

Canada's Tax Court has rejected an attempt by the tax authorities to apply the GAAR—General Anti-Avoidance Rule—in a case involving treaty shopping. The case—*MIL (Investments) SA v Her Majesty the Queen*—involved a capital gain realized by a non-resident of Canada who held his shares in a Canadian public company through a Luxembourg company. That Luxembourg company met the test for exemption from Canadian taxation under the terms of Article 13 of the Canada-Luxembourg tax treaty. The government argued, however, that GAAR applied and that the Luxembourg company that held the shares was therefore subject to Canadian tax on the gain. The Tax Court did not uphold that argument.

Treaty shopping was not, in itself, abusive, the court said.

Changing Residence to Luxembourg

The basic facts were these. An individual resident in Belize, who had acquired a significant shareholding in a Canadian public company, transferred his shares to a newly incorporated Cayman Islands company, MIL Investments, which was later converted to a Luxembourg company under the same name. Luxembourg has a tax treaty with Canada where, under Article 13, a capital gain on the sale of shares of a Canadian company held by a Luxembourg resident is not taxable in Canada, where the value of the company is principally due to immovable property in Canada used in a business or if the immovable property is not used in a business, if the Luxembourg resident owns less than 10 percent of the Canadian company, which was the case here by the time of the transaction at issue, largely due to an exchange of shares with a third-party company, Inco, which was the eventual purchaser of the Canadian shares. Luxembourg tax is only payable on any appreciation in value after incorporation in Luxembourg.

Shortly after the removal to Luxembourg, shares in the Canadian company were sold at a significant gain, and treaty exemption was claimed. It was, however, the final sale of shares in the Canadian company, which realized a gain of over CAD 420 million (EUR 295 million; $360 million) for which Revenue Canada refused exemption, on the grounds that this was an avoidance transaction, for which treaty exemption was overruled by Canada's statutory GAAR. In 2005, some nine years after the transactions, Canada passed legislation with retroactive effect clarifying that the GAAR applied equally to tax treaties.

Non-Tax Reasons for Transaction

The taxpayer at trial conceded that the tax treaty exemption claim was a tax benefit. The government argued that there were transactions that were avoidance transactions, in particular, the exchange of shares with Inco where, after the exchange, the taxpayer MIL owned less than 10 percent of the Canadian company.

Perhaps surprisingly, the Tax Court agreed with the taxpayer that there were good non-tax reasons for the tax-deferred exchange with Inco and therefore there was no tax avoidance (the government also made other arguments that there was tax avoidance, to no avail), even though there was evidence that the taxpayer had had Canadian tax advice in choosing to transfer the residence of MIL into Luxembourg and events at the time were pointing to a buyout.

The ruling on tax avoidance is very fact-specific. However, even though it was not necessary, the tax court went on to rule that had there been tax avoidance, the avoidance was not abusive. Treaty shopping was not, in itself, abusive, the court said. At all times, the taxpayer was a non-resident of Canada and the decision to continue from the Cayman Islands to Luxembourg did not change the fact that the taxpayer was a foreign company owning shares of a Canadian corporation. He concluded that because Canada and Luxembourg had not included an explicit reference to anti-avoidance rules when drafting their treaty (drafted in 1990 at a time when both Canada and Luxembourg had anti-avoidance legislation), in his view this meant that the "ordinary meaning" of the treaty allowing MIL to claim the exemption from Canadian tax must be respected.

It will be interesting to see the impact that this case will have. However, this decision is certainly good news for taxpayers who are concerned that the GAAR may apply to treaty shopping—it appears that the Tax Court's view at least is that GAAR should not apply.

The decision may be the subject of an appeal to a higher Court.

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UNITED STATES

Trademarks

Trademark Dilution Revision Act of 2006 Signed Into Law

By David J. Stewart and Charlena L. Thorpe
(Alston & Bird LLP)

On October 6, 2006, President Bush signed into law the Trademark Dilution Revision Act of 2006 ("TDRA"). The TDRA revitalizes and broadens the reach of federal dilution laws that had been substantially narrowed three years ago by the Supreme Court's decision in *Moseley v. V Secret Catalogue*, 537 U.S. 418 (2003) and by other federal court decisions. Although the TDRA modifies the former Federal Trademark Dilution Act ("FTDA") in a number of ways, the most significant changes are that it:

(1) Amends the FTDA's seminal proof requirement from actual dilution to *likelihood* of dilution;
(2) Clarifies that marks must be famous across all markets and not just in a niche market segment to qualify for protection under the Act;
(3) Clarifies that dilution by tarnishment is actionable; and
(4) Clarifies that descriptive marks that acquire secondary meaning and fame are protected under the Act.

Background on Dilution and the FTDA

Dilution is defined as the lessening of the capacity of a mark to identify and distinguish goods or services. Unlike trademark infringement laws, which are designed to protect the public from confusion, dilution laws exist only to protect the quasi-property right that a mark owner has in the integrity and distinctiveness of its mark. As such, neither competition nor confusion is a required element of a dilution claim.

Dilution can occur either by "blurring" or "tarnishment." Dilution by blurring occurs when a third party's use of the same or a similar mark causes the mark to lose its ability to serve as a unique identifier of the plaintiff's product. Examples of marks that could lead to dilution by blurring are DUPONT shoes, BUICK aspirin, and KODAK pianos. Dilution by tarnishment occurs when a mark is improperly associated with an inferior or offensive product or service. The use of XEROX to identify the sale of unlawful pharmaceuticals would be an example of dilution by tarnishment.

Since as early as 1947, state statutes have existed to protect owners of strong marks against dilution. However, most states did not enact dilution laws until after the publication of the Model State Trademark Bill of 1964, which created a cause of action for trademark dilution. Despite the creation of the Model State Trademark Bill, only approximately 25 states have enacted trademark dilution laws, the scope of which varies from state to state. For instance, some state dilution laws require a plaintiff to establish actual dilution to prevail on a claim of trademark dilution while others only require a showing of only a likelihood of dilution. Furthermore, the level of fame of a mark protected by state dilution laws differs from state to state, with some states requiring fame and others requiring only that the plaintiff's mark be distinctive. Still further, the scope of available injunctive relief under state anti-dilution laws (e.g., nationwide, multi-state, or only within the state) varies from state to state. Accordingly, prior to the enactment of a federal trademark dilution statute, an owner of a famous mark that was used nationwide likely would have to file suit in each state in which dilution protection was needed. This resulted in piece-meal litigation with the possibility of conflicting results. The Federal Trademark Dilution Act was enacted in 1995 to bring uniformity to dilution protection for famous marks, prevent forum-shopping, and reduce the cost to litigate trademark dilution claims.

Almost immediately after the FTDA's enactment, federal courts began to disagree over a number of issues related to the interpretation and enforcement of the statute. These issues included: (1) whether the FTDA requires proof of actual dilution or only a likelihood of dilution; (2) whether marks that are famous only in a niche market segment qualify for protection under the FTDA; (3) whether marks that were initially descriptive but that are now famous are covered by the FTDA; and (4) whether dilution by tarnishment is actionable under the Act. To the surprise of many, a unanimous Supreme Court resolved the first issue in *Moseley* by holding that actual dilution is required, a burden that would be difficult if not impossible for trademark owners to meet in most cases.

Trademark Dilution Revision Act of 2006

The TDRA was introduced on February 9, 2005, in direct response to the *Moseley* decision. The bill was passed by Congress on September 25, 2006, and signed by President Bush on October 6, 2006. The TDRA replaces the FTDA as Section 43(c) of the Lanham Act.

The TDRA expressly overturns *Moseley* by amending the FTDA to require only a likelihood of dilution. Specifically, the TDRA states that "the owner of a famous mark . . . shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is *likely to cause dilution* . . . ."

To determine whether a mark is likely to cause dilution by blurring, which the TDRA defines as "association arising from the similarity between a mark or trade name and a famous mark that impairs the distinctiveness of the famous mark," the TDRA adds several relevant factors that a court may consider. These factors include, but are not limited to: (i) the degree of similarity between the mark or trade name and the famous mark; (ii) the degree of inherent or acquired distinctiveness of the famous mark; (iii) the extent to which the owner of the famous mark is engaging in substantially exclusive use of the mark; (iv) the degree of recognition of the famous mark; (v) whether the user of the mark or trade name intended to create an association with the famous mark; and (vi) any actual association between the mark or trade name and the famous mark.

Other significant changes contained in the TDRA include the following:

Dilution by Tarnishment Clarified as Being Actionable

Justice Stephens stated in dicta in *Moseley* that the FTDA is limited to claims for dilution by blurring. To clarify this issue, the TDRA states that "the owner of a famous mark . . . shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is likely to cause dilution by blurring *or dilution by tarnishment* of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury." The TDRA defines "dilution by tarnishment" as "association arising from the similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark." The TDRA does not include any factors to guide judicial determination of dilution by tarnishment.

Claims of Dilution for Niche Fame Eliminated

Prior to passage of the TDRA, several federal courts held that the FTDA applies to marks that are famous in niche market segments but not to the consuming public as a whole. The TDRA eliminates such claims by defining a famous mark as a mark that "is widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner."

Descriptive Marks Clarified as Being Protected

In 2001, the Second Circuit significantly narrowed the reach of the FTDA by holding that descriptive marks are not protected by the FTDA, even if those marks have acquired secondary meaning. Thus, marks such as AMERICAN AIRLINES, DISNEY, and GENERAL ELECTRIC are not protected by the FTDA in the Second Circuit. The TDRA amends the prior act to clarify that descriptive marks that acquire distinctiveness and fame are subject to protection under the Act. Specifically, the TDRA amends Section 43(c)(1) to read as follows: "(1) INJUNCTIVE RELIEF- Subject to the principles of equity, the owner of a famous mark that is distinctive, *inherently or through acquired distinctiveness*, shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark…."

To reinforce this amendment, the fame factors of the FTDA have been amended by dropping the first fame factor of the old act, which instructed courts to consider "the degree of inherent or acquired distinctiveness of the mark." The restated fame factors read as follows: "(i) the duration, extent, and geographic reach of advertising and publicity of the mark, whether advertised or publicized by the owner or third parties; (ii) the amount, volume, and geographic extent of sales of goods or services offered under the mark; (iii) the extent of actual recognition of the mark and (iv) whether the mark was registered under the Act of March 3, 1881, or the Act of February 20, 1905, or on the principal register."

Burden of Proof Added for Claims Related to Unregistered Trade Dress

Although the FTDA did not explicitly address trade dress, federal courts have held that the statute applies to dilution of trade dress that is famous. In response to concerns from goods manufacturers, the TDRA includes a provision that requires owners of trade dress that is not registered with the U.S. Patent and Trademark Office to prove that the claimed trade dress is not functional and is famous without reference to any word marks that may be included as part of the trade dress. This added provision is more a clarification of existing law than a departure from prior law. Nevertheless, it creates another incentive for owners of famous trade dress to register their trade dress with the Trademark Office.

Conclusion

The TDRA reinvigorates and broadens federal dilution law by changing the standard to a likelihood of dilution and by clarifying that descriptive marks qualify for protection under the Act. Nevertheless, the TDRA simultaneously narrows the statute by eliminating protection for niche fame. Owners of marks with only niche fame must now turn to either state dilution laws or federal unfair competition laws for protection. Since the TDRA bars state law dilution claims against marks that are federally registered, state dilution laws may be of little assistance if the objectionable mark is federally registered.

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Taxation

IRS Closes Door to Tax-Free Transfers of Stock from U.S. Subsidiaries to Foreign Parent Company

Notice Targets Triangular B Reorganizations

By Jack Cummings and Kevin Rowe (Alston & Bird)

Overview

Notice 2006-85 shuts down a scheme that the IRS apparently has known about for some time by which CFCs or U.S. subsidiaries of foreign parents can repatriate earnings without U.S. tax to the parent through triangular reorganization rules. Basically the idea is that the CFC or the subsidiary uses the parent stock in a triangular reorganization, but pays the parent for the stock rather than receiving it as a contribution to capital. The payment is received by the parent tax-free under code section 1032, or at least it arguably was received tax free prior to the Notice.

Background

Generally speaking, in a "triangular" reorganization the acquiring corporation uses stock of its parent company as the consideration issued in exchange for the target's assets or stock. So, for example, in a triangular B reorganization, the acquiring corporation acquires target stock solely in exchange for voting stock of its parent corporation. Neither the acquiring corporation nor the target shareholders recognize gain in this transaction. The parent corporation does not recognize gain on the transfer of its shares under code section 1032, which provides generally that a corporation does not recognize gain on the transfer of its own shares. No gain is recognized by the parent company whether it first transfers its shares to the acquiring subsidiary that then transfers them to the target shareholders, or whether it transfers the shares directly to the target shareholders.

The Killer B Transaction

Assume a U.S. corporation (USP) owns 100 percent of the stock of a foreign corporation (CFC1) and a U.S. corporation (USS1). USS1 owns 100 percent of the stock of a second foreign corporation (CFC 2). In the first step of the transaction, CFC1 purchases USP voting stock from USP for cash equal to the fair market value of the parent stock (repatriation). Next, CFC1 acquires all of the stock of CFC2 from USS1 in exchange for USP voting stock. The transfer of USP voting stock to USS1 for CFC2 qualifies as a tax-free triangular B reorganization and the reorganization provisions protect all other parties from recognition of gain. Under code section 1032, USP does not recognize income on the receipt of cash from CFC1 for USP voting stock. At the end of the day, CFC2 has been relocated within the group and USP has received cash from CFC1 tax free.

The Killer B transaction threads a number of rules. Code section 956 creates taxable subpart F income to U.S. shareholders when a CFC acquires certain types of U.S. property including stock in the CFC's U.S. parent, but only if the CFC owns the U.S. property on the last day of the calendar quarter. For purposes of code section 956, the U.S. property of a CFC is the average value of the U.S. property held by the CFC on the last day of each quarter during the year. The Killer B transaction is carefully structured so that the CFC does not own USP stock on the last day of any quarter. Code section 304 (which may recast consideration received in certain stock transfers among related companies as a dividend) is also inapplicable because it does not apply to the transfer by a shareholder of its own stock to a controlled corporation. The transaction does result in the awkward structure of a subsidiary owning stock in its parent company, which may generate complications under the consolidated return regulations. The other variation of the Killer B transaction is designed to "strip" earnings out of the U.S. subsidiary of a foreign corporation without paying withholding tax on dividends. In this version, the domestic subsidiary of a foreign parent company purchases stock of the parent for use in a tax-free triangular reorganization and it takes the position that the transfer of cash to the parent is a code section 1032 transaction and not a dividend subject to withholding tax.

The regulations apply to transactions occurring after September 22, 2006.

Notice 2006-85

The Notice states that regulations will be issued under code section 367(b) to treat the payment from the subsidiary to the parent company for parent company stock as a taxable distribution that is separate from the acquisition of parent company stock in connection with the triangular reorganization. The regulation will apply only where *(i)* the parent or the subsidiary that acquires parent stock, or both, is foreign, *(ii)* the subsidiary acquires parent stock to use in a triangular reorganization, and *(iii)* the subsidiary purports to buy the parent stock rather than receive it in a capital contribution. Under the forthcoming regulations, the subsidiary will be treated as if it acquired the parent company stock in a capital contribution from the parent company. The regulations will apply to transactions occurring on or after September 22, 2006. The regulations will not apply to a transaction that was completed after such date, provided the transaction was entered under a written agreement that was binding before September 22, 2006, and at all times thereafter.

Analysis

While a pronouncement shutting down the Killer B transaction had been expected, the reasoning in the Notice is interesting. The regulation will be issued under the broad regulatory authority of code section 367(b). That section authorizes regulations addressing tax-free transactions involving foreign corporations in which there is no outbound transfer of property subject to code section 367(a) (i.e., a transfer by a U.S. person to a foreign corporation where the tax-free character of the transfer requires that the transferee be a corporation). Code section 367(b) seems to be an appropriate source of regulatory authority where the parent company is domestic and the acquiring subsidiary is a CFC because this structure is intended to avoid subpart F (notwithstanding that code section 956(a) measures a CFC's investment in U.S. property for purposes of the deemed dividend based on the average of such investment at the end of each quarter).

It is more questionable whether code section 367(b) is the appropriate source of authority where the U.S. subsidiary of a foreign parent company purchases stock in the parent company for use in a triangular reorganization. Since it is always within the authority of the IRS to question whether a payment to a shareholder that is linked to another event is or is not a distribution with respect to stock, one wonders why the IRS did not invoke another section of the code. Possibly section 1.1032-3(b)(2) of the regulations was seen as a constraint because it states that the subsidiary in a triangular reorganization may pay the parent for all or part of the stock it will use in the triangular reorganization without triggering recognition of taxable gain.

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IRS, Foreign Tax Authorities to Share More Information

By Lou Carlow and John Manton (PricewaterhouseCoopers)

The IRS and some U.S. treaty partners are determining if there is additional tax information that may be of use for purposes of information exchange. It is our understanding that certain treaty partners have expressed an interest in receiving information reported on Form 8288-A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests, and Form 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax. If it is decided to provide this information under the Routine Exchange of Information Program, the information will be provided automatically to the requesting treaty partners.

Background

Currently, information exchange provisions contained in U.S. tax treaties allow the United States and its treaty partners to share information in order to carry out the treaty provisions or the domestic laws pertaining to taxes covered in the treaties. The IRS has five exchange of information programs:

- Routine Exchange of Information Program
- Specific Exchange of Information Program
- Spontaneous Exchange of Information Program
- Industrywide Exchange of Information Program
- Simultaneous Examination and Simultaneous Exchange of Information Programs

Under the Routine Exchange of Information Program, the IRS automatically provides information that is not specifically requested by the receiving country. At this time, the information provided under this program is limited to the information reported on Forms 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, relating to U.S. source fixed or determinable income paid to persons claiming to be residents of the receiving treaty country.

Observations

The IRS Commissioner's involvement in developing strategies to address the increased compliance challenges that come from globalization has resulted in the IRS working with tax administrations of other countries. The IRS and the tax agencies of the United Kingdom, Canada, and Australia have established the Joint International Tax Shelter Information Center in order to identify, develop, and share information about abusive tax avoidance transactions.

The IRS also is working with the tax administrations of nine other countries in an arrangement where the parties meet regularly to discuss issues of global and national tax administration that present mutual compliance challenges. These information sharing arrangements, coupled with the IRS promise to address the criticism it received for not utilizing information received from treaty partners in the past, is a strong indication that the IRS will be sharing information and using information it receives in its compliance efforts in the future.

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Trade

Regional Perspectives: APEC: The Annual Asia Road Show

By Eric Shimp (Alston & Bird LLP)

The Asia Pacific Economic Cooperation (APEC) forum is often maligned as little more than a salon for national leaders to play the part of global statesmen. The 21 APEC economies, however, are home to over 2.5 billion people, and boast a collective GDP of $19 trillion. Moreover, APEC members dominate some 47 percent of global trade. Those numbers alone demand attention.

This year's annual summit, held later this month in Hanoi, will be remarkable not for press statements or photo ops between heads of state, but for machinations behind the scenes that are gradually determining dominance in half of the global economy.

Publicly, APEC's year-end summitry will be dominated by high diplomacy regarding North Korea's nuclear gambit. U.S. statements and meetings held by President Bush will attempt to focus regional energies on containing North Korea in the same manner that the Administration used APEC in the autumn of 2001 to garner support for the global war on terror in the wake of September 11. The likely media focus on security issues, however, will overshadow strong currents moving the region's economy in new directions.

The Bush Administration has few concrete items to deliver in Hanoi this month. The President will not travel to Vietnam having secured passage of Permanent Normal Trade Relations legislation. Instead, Vietnam will most likely accede to the WTO in January without realizing new U.S. market access. The Administration will also not use APEC as the launch point for new FTA negotiations in the region, focusing instead on slow, ongoing talks with Korea and Malaysia. Expect instead a rhetorical commitment to resuscitating the WTO Doha Round, political pressure on FTA partners to deliver at the table, statements aimed at deflecting domestic criticism of the trade deficit with China, and the overwhelming focus on North Korea. This year at least, Washington may miss the most significant developments at APEC, which will reflect a fully formed competition for economic supremacy in Asia.

*See **APEC,** page 16➢*

➢**Trade,** *from page 1*

Trade in Numbers

29 - seats gained by Democrats in House (10 undecided)

6 - seats gained by Democrats in Senate

33 - new Democrat majority in House (229 to 196)

2 - new Democrat majority in Senate (51 to 49)

2 - margin of vote ratifying Central American Free Trade Agreement (CAFTA) in 2005

number of legislators who voted for CAFTA who lost their seats in

21 - House

5 - Senate

2 - concluded Free Trade Agreements (FTA) awaiting ratification in the 110th Congress

5 - FTAs now under negotiation that could also come before the 110th Congress

6 - other major trade/investment legislation which will likely come before the 110th Congress (i.e., GSP renewal)

foreign market declines on morning after U.S. elections

– .53% FTSE 100

– .44% DAX 30

– .47% CAC40

– 1.10% Nikkei

If one superimposes the electoral demographics of the 2008 presidential campaign upon the results of the midterm elections, the result is a bleak picture for trade policy and legislation in the 110th Congress.

In what will surely be the battleground states in 2008 – Ohio, Pennsylvania, and Missouri – newly minted freshman senators ran on strong anti-trade platforms. Considering the significance of the states they represent in the national election process, those senators should enjoy a disproportional influence over party positions on trade and economic policy.

The worst case scenario is that a Democratic initiative to produce "fair" or "managed trade" will prove to be a slippery slope to protectionism. If the new Congress crafts trade legislation that attempts to pick winners and losers in the economy – and if those choices reflect political objectives regarding the 2008 campaign rather than a careful shepherding of the nation's long-term global competitiveness – then the Democrats will have failed a key test of governance. Look for tensions between freshmen "fair trade" Democrats and pro-trade New Democrats to feature in the early battles of the new Congress, at precisely the time when the party's slight majority requires unity.

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➢*APEC, from page 14*

Regional Competition for Economic Hegemony

Beginning in 2002, China has pursued an aggressive trade strategy in the region aimed at fostering not only economic influence, but offering a "soft" approach to pave the way for Beijing's security objectives in Asia. China has launched or completed FTAs with the entire ASEAN bloc – Thailand, India, Australia, New Zealand, Korea, and Chile - two-thirds of the APEC economies.

China frequently leverages early harvest packages of tariff concessions to developing Asian countries to provide quick political gains to foreign leaders concerned by surges of Chinese imports.

Japan's leaders allowed their dedication to the multilateral negotiating ideal of the WTO to dominate decision-making until recently, when fears of Chinese influence combined with the imminent failure of the Doha Round to spur a new approach to regional trade. During the first half of 2006, Japan proposed the Comprehensive Economic Partnership in East Asia, aiming to integrate 16 Asian economies within 10 years. This so-called Nikai Initiative has met with a lukewarm response in regional capitals as well as Washington, which remains concerned about any regional institution that bars American involvement. In the meantime Japan has intensified effort to reclaim its historic influence in Southeast Asia, launching FTAs with seven of the ASEAN members as well as with the bloc itself. Late to the game and hamstrung by severe agricultural protectionism at home, Japan's leverage for negotiating meaningful agreements has been limited.

New Wrinkles, New Contests

Indian economic growth, slower and less remarked than that of China, has introduced a new and evolving variable into the Asian political economy; India is emerging as a strategic competitor to the major North Asian powers. Delhi's landmark agreement with the United States regarding India's nuclear assets is a notable departure from U.S. policy regarding non-proliferation. India has also quietly sought an independent leadership role on trade, not only via the WTO, but also increasingly through direct negotiation for FTAs with ASEAN members, China, Japan and Korea.

Regional debates over issues of economic integration, including matters such as a single Asian currency, an Asian Monetary Fund to rival the IMF, and ongoing efforts to firmly establish a domestic Asian bond market, will increasingly be required to consider Indian concerns. As this new element courses through the region, China and Japan as well as the United States, will experience new tensions that add to the dynamism and complexity of the world's most hotly contested region.

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