

# **Welcome to the Jury System: Supreme Court Limits Sovereign Immunity for State-Owned Companies**

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What do foreign businessmen fear most about US courts? Almost universally, it is facing a jury. Texaco lost US\$11 billion in a Texas state court when it interfered with Pennzoil's contract to buy Getty Oil; McDonald's had to pay millions when a customer spilled hot coffee on her lap; and a Canadian funeral home company, Loewen Group, Inc, was forced into bankruptcy by a US\$500 million jury award arising from a US\$4 million contract dispute.<sup>1</sup> These stories and others have foreign businessmen rushing to make bad settlements when they have disputes with US companies. A bad deal is better than the uncertainty of a jury verdict, according to many foreign executives. It must be hard for foreign government officials to imagine that the US Government would conduct foreign affairs through a jury. But that is what is about to happen.

In a recent decision, *Dole Food Co v Patrickson*,<sup>2</sup> the US Supreme Court severely limited the protections provided by the Foreign Sovereign

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1 *Texaco, Inc v Pennzoil, Co*, 729 SW 2d 768 (Tex 1987) (US\$3 billion jury verdict remitted to US\$1 billion); Albert Hunt, 'The Bogus Tort Reform Case', Wall St J, 6 March 2003, at A3 (concerning the McDonald's case); *The Loewen Group, Inc v United States*, Case No ARB/AF/98/3, ICSID Award (23 June 2003) (located at [www.state.gov/s/1/c3755.htm](http://www.state.gov/s/1/c3755.htm)).

2 538 US 468 (2003) ('*Patrickson*').

Immunities Act (FSIA)<sup>3</sup> to state-owned companies. The FSIA is the sole basis for jurisdiction over a foreign state and its instrumentalities in US courts and, therefore, it defines the limits of when and how foreign governments and their enterprises can be sued in US courts.<sup>4</sup> In a product liability lawsuit by Latin American farm workers against two Israeli companies, the court held that only state companies directly owned by a foreign state would be protected by the FSIA.<sup>5</sup> The lower level or 'tiered' subsidiaries of state-owned companies now fall outside the Act and will be treated like any other foreign corporation.<sup>6</sup> Without the immunities provided by the FSIA, companies conducting important public business are likely to be sued more often and have their disputes decided in the less predictable atmospheres of state courts, before local juries and without a consistent body of law to guide the decision-making process.

Many state companies follow traditional corporate structures similar to private companies with a parent and subsidiaries to separate various projects or enterprises. These structures were developed to encourage good corporate management and control and to facilitate financing. The *Patrickson* decision, however, raises serious questions about whether developing countries should restructure their state enterprises to retain FSIA protections.

#### Lawsuit

In 1997, a group of banana workers from Costa Rica, Ecuador, Guatemala and Panama filed suit in a Hawaii state court against Dole Food Company ('Dole') alleging injury from exposure to dibromochloropropane.<sup>7</sup> Dole joined Dead Sea Bromine Co, Ltd and Bromine Compounds, Ltd (collectively, 'Dead Sea Companies'), the manufacturers of some of the pesticide, as parties to the lawsuit.<sup>8</sup> The Dead Sea Companies removed the claims to federal court claiming to be instrumentalities of Israel, a foreign state under the FSIA.<sup>9</sup> The District Court held that the Dead Sea Companies were not instrumentalities of a foreign state for purposes of the FSIA.<sup>10</sup> The State of Israel never had direct ownership of shares of either company; they were separated from the state by one or more intermediate corporate tiers.

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3 The Foreign Sovereign Immunities Act of 1976, Pub L No 94-583, 90 Stat 2891, 28 USC §§ 1602-1611 (FSIA).

4 *Republic of Argentina v Weltover, Inc*, 504 US 607, 610-11 (1992).

5 *Patrickson*, 538 US at 474.

6 *Id*.

7 *Id* at 470.

8 *Id*.

9 *Id* at 472.

10 *Id*.

The companies thus were not entitled to removal on that basis.<sup>11</sup> The District Court, however, accepted the case on the assertion of the Dole defendants that federal jurisdiction could be based on the common law of foreign relations, the doctrine that issues affecting the sovereign interests of a foreign government should be decided by a federal court.<sup>12</sup> The Court of Appeals reversed the order rejecting both the common law of foreign relations and the FSIA as bases for jurisdiction.<sup>13</sup>

### Supreme Court decision

The Supreme Court agreed to hear the appeal and held that a foreign state must itself own most of the shares of a corporation if the corporation is to be deemed an instrumentality of the state under the provisions of the FSIA.<sup>14</sup>

Section 1603(a) of the FSIA defines 'foreign state' to include an 'agency or instrumentality of a foreign state'.<sup>15</sup> 'Agency or instrumentality of a foreign state' is defined, in turn, as:

'Any entity –

- (1) which is a separate legal person, corporate or otherwise, and
- (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and
- (3) which is neither a citizen of a State of the United States . . . nor created under the laws of any third country.'<sup>16</sup>

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> By the time of the lawsuit, Israel had privatised both companies. The Court of Appeals noted, but declined to answer, the question whether status as an instrumentality of a foreign state is assessed at the time of the alleged wrongdoing or at the time the suit is filed. Instead, the Court of Appeals held that it did not matter because, either way, the Dead Sea Companies were not instrumentalities of Israel under the FSIA's definition of instrumentality. The Supreme Court decided that for jurisdictional purposes, status is relevant as of the time the lawsuit was filed. *Patrickson*, 538 US at 478.

<sup>14</sup> The Supreme Court did not decide whether the lower courts had jurisdiction under the common law of foreign relations. 538 US at 472. The circuit court had rejected this doctrine which was adopted by the Fifth Circuit in *Torres v Southern Peru Copper Corp*, 113 F 3d 540, 543 (5th Cir 1997), a case in which the author's firm represented the Peruvian Government. *Patrickson v Dole Food Co, Inc*, 251 F 3d 795, 799 (9th Cir 2001), *aff'd in part*, 538 US 468 (2003). In *Torres*, the Fifth Circuit held that the federal court had jurisdiction over a toxic tort suit brought by Peruvian citizens against a Texas mining company when the Peruvian Government sent a diplomatic objection to the State Department and filed an *amicus* brief to complain that the pending lawsuit would interfere with its regulation of its mining industry, a critical sector of its economy. See also *Pacheco de Perez v AT&T Co*, 139 F 3d 1368, 1377 (11th Cir 1998) (Venezuelan citizens injured in a pipeline explosion).

<sup>15</sup> 28 USC § 1603(a).

<sup>16</sup> 28 USC § 1603(b) (emphasis added).

It is the second prong of this definition that was the basis for the decision. The Supreme Court held that 'only direct ownership of a majority of shares by a foreign state satisfies the statutory requirement' and that a subsidiary of an instrumentality is not itself entitled to instrumentality status.<sup>17</sup>

The Dead Sea Companies relied on three arguments to support their position that 'ownership' in 1602(a) should include tiered subsidiaries. The court should:

- (1) 'ignore corporate formalities and use the colloquial sense of the term "owned";
- (2) pierce the corporate veils; or
- (3) rely on Israel's effective control over the companies.<sup>18</sup>

The court, however, reasoned that linguistic indicia in the statute demonstrated that Congress had corporate formalities in mind when drafting the FSIA, saying: 'In issues of corporate law structure often matters.'<sup>19</sup> The court did not look at the statutory history or the policies underlying the FSIA; but instead relied on the 'plain meaning' of one of the most complex and confusing statutes in the law books, concluding: 'The text of the FSIA gives no indication that Congress intended us to depart from general rules regarding corporate formalities.'<sup>20</sup> As to the 'effective control' argument, the court countered 'control and ownership are distinct concepts'.<sup>21</sup>

#### **Justices Breyer and O'Connor dissent**

Justices Breyer and O'Connor dissented from the majority opinion because, in their opinion, the phrase "Other ownership interest . . . owned by a foreign state", covers a Foreign Nation's legal interest in a Corporate Subsidiary, where that interest consists of the Foreign Nation's ownership of a Corporate Parent that owns the shares of the Subsidiary'.<sup>22</sup> '[W]hat might lead Congress to grant protection to a Foreign Nation acting through a Corporate Parent but deny the same protection to the Foreign Nation acting through, for example, a wholly owned Corporate Subsidiary?', the dissent asked and then concluded, '*nothing at all* would lead Congress to make such a distinction'.<sup>23</sup>

The dissent attacked the majority's argument to examine the 'plain text' of the statute, because '[t]he statute's language, standing alone, cannot

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<sup>17</sup> 538 US at 474.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 476.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 480 (dissent).

<sup>23</sup> *Id.* at 485 (dissent) (emphasis in original).

answer the question. That is because the words “own” and “ownership” – neither of which is defined in the FSIA – are not technical terms or terms of art but common terms, the precise legal meaning of which depends upon the statutory context in which they appear’.<sup>24</sup> The dissent argued that the words ‘other ownership interest’ might refer to the kind of majority ownership interest that arises when a sovereign owns the shares of a parent that, in turn, owns a subsidiary.<sup>25</sup>

Unlike the majority, the dissent also found the purposes of the FSIA relevant. ‘Statutory interpretation is not a game of blind man’s bluff’, according to the dissent.<sup>26</sup> The Act provided foreign states with the right to have their cases decided by the “courts of the United States”, i.e. the federal courts’.<sup>27</sup> According to the legislative history, foreign states were given clear authority to remove their cases to federal court in light of ‘the potential sensitivity of actions against foreign states and the importance of developing a uniform body of law in this area . . . [A] disparate treatment of cases involving foreign governments may have adverse foreign relations consequences’.<sup>28</sup> The FSIA also sought to ensure that unbarred claims should be decided in the same manner as a private corporation but with certain safeguards.<sup>29</sup>

The dissent relied on the report of the American Bar Association Working Group, ‘Reforming the Foreign Sovereign Immunities Act’<sup>30</sup> to support its opinion.

### **ABA Working Group Report**

In mid-1998, the International Litigation Committee of the American Bar Association’s Section of International Law and Practice created a Working Group to examine the split in judicial authority and ambiguities in the FSIA. The mission of the Working Group was to evaluate the operation of the FSIA and consider whether any amendments should be recommended.<sup>31</sup>

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24 *Id* at 481 (dissent).

25 *Id* at 482 (dissent).

26 *Id* at 484.

27 *Id*.

28 *Id* at 484-485 citing HR Rep No 94-1487 (1976) at 32.

29 *Id* at 485-486.

30 See ABA Working Group Report, *Reforming the Foreign Sovereign Immunities Act* (2002) 40 Colum J Transnat’l L 489.

31 *Id* at 494-495.

The Working Group anticipated the *Patrickson* problem, finding that courts 'have struggled' with the issue of whether tiered subsidiaries fall within the FSIA.<sup>32</sup> Most courts have included tiered subsidiaries within the Act but the results have been inconsistent. 'After carefully considering the case law and the purposes and structure of the Act, the Working Group concluded that the Act should be applied both to entities majority owned or held by an instrumentality',<sup>33</sup> explaining:

'The principal reason behind the Working Group's recommendation for the application of presumptive sovereign immunity to corporations indirectly majority owned by foreign states is that some states utilise a tiered corporate structure to manage and control important areas of national interest, such as natural resources.'<sup>34</sup>

Mexico, for instance, has a national petroleum company with four subsidiaries, and Honduras holds interests in its lumber industry in two corporate layers.<sup>35</sup> 'The strength of a foreign state's sovereign interests in an area does not necessarily dissipate when it employs more complicated legal structures resembling those used by modern private businesses', the ABA Working Group concluded.<sup>36</sup> The ABA Working Group, thus, gave great weight to the foreign policy purposes of the FSIA.

The ABA Working Group, however, recognised the counter-arguments, saying 'as a corporation becomes more distant from the foreign state, a plaintiff is much less likely to be aware that the entity benefits from sovereign immunity and therefore is less likely to obtain explicit waivers in contracts or to comply with the Act from the beginning of an action against the entity'.<sup>37</sup> The ABA Working Group, therefore, recommended an amendment that would recognise that tiered subsidiaries fall within the FSIA but would provide a presumption that these subsidiaries presumptively engaged in commercial activity.<sup>38</sup> The amendment would give tiered subsidiaries the procedural benefits of the statute while relieving plaintiffs of the burden of proving an exception to immunity.

### **Patrickson's impact**

So what does *Patrickson* mean for state-owned companies? If a state owns a majority of shares in a corporation that, in turn, owns most shares in a

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<sup>32</sup> *Id* at 517.

<sup>33</sup> *Id* at 522.

<sup>34</sup> *Id* at 523.

<sup>35</sup> *Id*.

<sup>36</sup> *Id*.

<sup>37</sup> *Id*.

<sup>38</sup> *Id*.

subsidiary corporation, the subsidiary corporation does not fall within the definition of an instrumentality. The case leaves open the possibility that certain tightly controlled entities will be considered 'organs' of the foreign state and still fall within the FSIA.<sup>39</sup> The statute includes 'organs' within the definition of instrumentality but then does not define the term 'organ'.<sup>40</sup> The meaning of 'other ownership interest' in the definition section also remains ambiguous and subject to arguments that certain entities, like independent regulatory agencies, fall within the statute.<sup>41</sup> In most circumstances, however, tiered subsidiaries will be treated like private corporations even though many are responsible for important areas of national interest.

The most immediate effect of this change is that tiered subsidiaries will lose their immunities from US lawsuits and protections for their property. The FSIA provides immunity from suit for foreign states and their instrumentalities subject to limited exceptions.<sup>42</sup> Two lawsuits already have been affected. In February 2003, the district court dismissed a suit against two of three Korean banks accused of defrauding investors in the shares of a speech products company by engaging in sham transactions with the company.<sup>43</sup> The court held that the two banks, which were owned by the Korean Deposit Insurance Corporation, were instrumentalities of Korea and their commercial activity did not have a direct effect in the United States, which would have provided an exception to immunity.<sup>44</sup> After *Patrickson*, the same court reversed itself and reinstated the lawsuit against the banks since the banks were no longer considered instrumentalities of Korea.<sup>45</sup>

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<sup>39</sup> 28 USC § 1603(a)(2).

<sup>40</sup> Several circuit courts have adopted a multi-factor balancing approach to determining whether an entity is an organ of a foreign state, which include: (1) the circumstances surrounding the entity's creation; (2) the purpose of its activities; (3) the degree of supervision by the government; (4) the level of government financial support; (5) the entity's employment policies . . . ; (6) the entity's obligations and privileges under the foreign state's law; and (7) the ownership structure of the entity. See *Kelly v Syria Shell Petroleum Dev BV*, 213 F 3d 841, 846-47 (5th Cir 2000); *EOTT Energy Operating Ltd P'Ship v Winterthur Swiss Ins Co*, 257 F 3d 992, 997 (9th Cir 2001); *USX Corp v Adiratic Ins Co*, 345 F 3d 190 (3d Cir 2003) *cert denied*, 541 US 903 (2004); *Filler v Hanvit Bank*, 378 F 3d 213 (2d Cir 2004), *cert denied sub nom, Chohung Bank v Filler*, \_\_\_ US \_\_\_, 125 S Ct 677 (2004).

<sup>41</sup> *Id.*

<sup>42</sup> 28 USC §§ 1604-5.

<sup>43</sup> *Filler v Hanvit Bank*, 247 F Supp 2d 425 (SDNY 2003); see 28 USC § 1605(a)(2).

<sup>44</sup> *Filler*, 247 F Supp 2d at 428-429.

<sup>45</sup> *Stonington Partners, Inc v Hanvit Bank*, No 02 Civ 8213, 2003 US Dist LEXIS 10974 (SDNY 30 June 2003). The court subsequently determined that the banks were not immune as organs of a foreign state. *Filler v Hanvit Bank*, 378 F 3d *supra* at 217-218, but the case was dismissed on the merits. *Filler v Hanvit Bank*, 339 F Supp 2d 553 (SDNY 2004).

In what may prove to be the more interesting case, the US Court of Appeals followed *Patrickson* in holding that survivors of a ski train accident in Austria can sue tiered subsidiaries of the Austrian Government in a New York court for damages and an injunction against operating the ski train, alleging that it was too dangerous.<sup>46</sup> A New York judge and jury, therefore, could decide how Austria should operate its ski industry. The suit seeks both compensatory and punitive damages for the accident. The concept of punitive damages does not exist in most legal systems and reflects a political judgment about the role of the court system that is not shared by most of the world. A large jury verdict or an injunction ordering Austria to stop operating its ski train could raise the kinds of foreign policy issues that the FSIA was designed to avoid. Are we going to send US marshals to enforce the injunction? If the Austrian state corporation were to defy an injunction and the court impose sanctions, the State Department could receive a strong diplomatic protest and ultimately Austria could retaliate against US interests in that country.

According to the legislative history, Congress considered the foreign policy implications of lawsuits to be one of the most important purposes of the FSIA.<sup>47</sup> The immunity provisions limited the types of disputes that would reach US courts, consistent with international law and practice. In *Patrickson*, the Supreme Court eliminated the most direct route foreign instrumentalities had to federal court. While some tiered subsidiaries may find another basis for federal jurisdiction, many more cases will be heard in state courts. By providing federal court jurisdiction, the FSIA provided a uniform set of rules for suits against foreign governments and their instrumentalities and ensured a generally uniform interpretation.<sup>48</sup> The FSIA's requirement of federal court jurisdiction recognised that foreign governments would expect their important public policy issues to be given the dignity of a decision by a US court and not the courts of a constituent entity such as a state, county or municipality. Federal courts are also more likely to give deference to views of the executive branch when it chooses to comment on important foreign

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46 *In re Ski Train Fire*, No 02-7391, 2003 US App LEXIS 10732 (2d Cir 29 May 2003). Since the Second Circuit's decision, a class was certified but rejected by the appeals court, *In re Ski Train Fire in Kaprun, Austria*, 220 FRD 195 (SDNY 2003), *rev'd sub nom, Kern v Siemens Corp*, 393 F 3d 120 (2d Cir 2005), and several defendants have been dismissed for lack of personal jurisdiction or on the merits, *In re Ski Train Fire in Kaprun, Aus*, 342 F Supp 2d 207 (SDNY 2004) and Nos MDL No 1428, 04 Civ 1402, 2004 US Dist LEXIS 23700 (SDNY 19 November 2004); and *Bartori v Am Permalight, Inc*, Nos 03 Civ 8960, 03 Civ 8961, 2004 US Dist LEXIS 23233 (SDNY 12 November 2004). The case, however, continues against the operator.

47 *Patrickson*, 538 US at 486 (dissent).

48 *Id.*



relations issues.<sup>49</sup> It is less certain that a statement of interest from the US Justice Department will sway a state court judge. And a state court jury will never hear the Government's foreign policy concerns because they will not be admissible as evidence.

The foreign policy concerns also run in the other direction. To the extent the United States gives less immunity in its courts, it is likely to receive less deference in foreign courts. The US Government, for instance, does not maintain bank accounts in Italy because Italian courts allow Italian citizens to attach US Government assets.<sup>50</sup> The *Patrickson* decision is not likely to improve the treatment of the US Government in foreign courts. Judgments against state instrumentalities also are likely to create other diplomatic disputes. Adverse court rulings tend to appear as negotiating issues in trade disputes or treaty negotiations of various kinds.

Of course, the state companies now will have to face jury trials. If state courts raise foreign policy concerns, juries will intensify those concerns. Juries will now decide important public policy issues relating to, for instance, the tourist industry in Austria or perhaps some day, the oil industry in Saudi Arabia.<sup>51</sup> After the past decade of privatisations, the remaining state-owned companies often are managing oil, mining, fishing and other politically sensitive resources. Most trial lawyers, this one included, will tell you that juries take their work seriously and usually come to the right result. And the presence of a state-owned company as a party will not necessarily change their attitude. For instance, in a case the author's firm tried, a New York jury awarded a Peruvian state-owned company US\$132 million when it sued the Hunt brothers for manipulating silver prices.<sup>52</sup> The stories of unusually high jury verdicts also tend to be inaccurately reported, not the final results in the case, or anomalies.<sup>53</sup> There is no doubt, however, that juries add an element of uncertainty that will make foreign officials uncomfortable, and

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49 For instance, the Justice Department has a practice submitting statements of interest or *amicus curiae* briefs in cases involving important foreign relations issues. See, eg, *First Nat'l City Bank v Banco Nacional de Cuba*, 406 US 759, 761 (1972) (Cuban expropriations); *Crosby v Nat'l Foreign Trade Council*, 530 US 363 (2000) (Massachusetts law infringed on foreign affairs powers); *CIBC Bank & Trust Co (Cayman) Ltd v Banco Cent do Brasil*, 886 F Supp 1105, 1108 (SDNY 1995) (sovereign debt).

50 Discussions with the former director of foreign litigation, US Justice Department.

51 See, eg, *In re Terrorist Attacks on September 11, 2001*, 349 F Supp 2d 765, 792 (SDNY 2005) (discovery permitted on whether a bank owned in part by the Saudi Government is an immune instrumentality).

52 *Minpeco, SA v Hunt*, 718 F Supp 168 (SDNY 1989).

53 See, eg, Lynn A Baker and Charles Silver, 'Introduction: Civil Justice Fact and Fiction' (2002) 80 Tex L Rev 1537, 1541; *The Bogus Tort Reform Case*, *supra*, at A3.

they occasionally can punish the outsider as they did in dramatic fashion with a US\$500 million verdict in the *Loewen* case.<sup>54</sup>

The FSIA also gave foreign states and their instrumentalities other harder to define benefits of federal courts. The quality of the judges and the justice is generally considered to be more consistent in federal court. Procedural doctrine like standing, burden of proof and *forum non conveniens* are generally more strictly enforced in a federal court. High supercedeas or appeal bonds in some states make appealing an adverse ruling very difficult. In the case of the US\$11 billion verdict against Texaco, for instance, the Texas state rules required a bond equivalent to the amount of the judgment before enforcement would be stayed pending appeal.<sup>55</sup>

Even where the FSIA allowed suits against tiered subsidiaries, the FSIA's procedural protections provided important protections, which they will no longer have. The FSIA provides instrumentalities with the right to more stringent service of process rules in order to ensure the companies received actual notice of lawsuits.<sup>56</sup> As an outsider in many jurisdictions, a tiered subsidiary may only be entitled to notice by publication.<sup>57</sup> A notice in the local newspaper of general circulation is considerably less likely to result in actual notice of the lawsuit than the FSIA procedures. The instrumentalities first actual notice of the lawsuit may be a call from its bank that its account has been blocked based on an execution of a state court default judgment.

Venue rules, which define where a lawsuit may be brought, also are limited in the FSIA.<sup>58</sup> The plaintiff's lawyer now will have much greater leeway to drag state-owned companies into unfriendly jurisdictions. The FSIA provides procedural protections for pre- and post-judgment attachment and execution. Property of foreign states and instrumentalities are generally immune from attachment and execution, subject to limited exceptions.<sup>59</sup> Where property can be seized, the FSIA provides instrumentalities with additional protections that are not available in state law. Plaintiffs must apply to the court for permission to attach assets.<sup>60</sup> After a judgment is entered, the plaintiff must get a court order that finds that a reasonable time has passed before execution is attempted.<sup>61</sup> These protections will no longer exist for tiered subsidiaries.

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54 See n 1 above.

55 *Tex R Civ P* 364 (1986).

56 28 USC § 1608(b).

57 Eg NYSurr Ct Proc Act Law § 307 (Consol 2003); Va Code Ann § 8.01-301 (2003).

58 28 USC § 1391.

59 28 USC § 1609.

60 28 USC § 1610(b).

61 28 USC § 1610(c); see, eg, *Elliott Assocs, LP v Banco de la Nacion*, 194 FRD 116 (SDNY 2000).

**Conclusion**

From the foreign state's standpoint, the solution to *Patrickson* is to consider reorganising the structure of state-owned companies to have them directly owned by the government. That may not be easy because lenders and creditors may have rights and may object. It may also create problems for accountability and control. The other solution is support the passage of the amendment proposed by the American Bar Association, which would re-establish immunity for instrumentalities.

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