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BREACH OF CONTRACT

Indemnification Provision Held To Be Applicable When Financial Statements Prepared By Seller For Chinese Authorities Misrepresented Actual Liabilities

In *Schwan-Stabilo Cosmetics GmbH & Co. v. PacificLink Intern. Corp.*, 401 F.3d 28 (2nd Cir. 2005), Defendants PacificLink International Corporation (PacificLink) and Paul Shieh appealed from a judgment granting Schwan-Stabilo Cosmetics GmbH & Co.'s (SSC) motion for summary judgment, denying the defendants' motion for summary judgment, and awarding SSC $492,525 plus interest, to be paid jointly and severally by the defendants.

SSC was a private German company specializing in cosmetics manufacture and distribution. For several years prior to the events giving rise to this dispute, Tianjin Kerma Laboratories Co., Ltd. (Kerma), a Chinese cosmetics manufacturer, distributed SSC's products. At the time, 99 percent of Kerma stock was owned by PacificLink (a New York corporation) and its chairman and sole shareholder, Shieh.

SSC and Shieh began discussing the possibility of SSC's acquiring a majority interest in Kerma, and in April 1999, the parties signed a letter of intent reflecting SSC's intention to buy 67 percent of Kerma's outstanding shares for $1 million. SSC then conducted a due diligence inquiry, and learned from its auditors about various liabilities carried by Kerma–including unpaid taxes, customs duties, and social insurance contributions–that were not disclosed on the financial statements that had been provided to SSC.

After SSC expressed to Shieh its concern about these apparent irregularities, Shieh assured SSC that the liabilities would not be realized. SSC then agreed to follow through with the deal as long as Shieh agreed to indemnify SSC in the event that the liabilities came due. An indemnification provision was included in the share purchase agreement (Agreement), which was executed by the parties on May 3, 2000. The indemnification provision capped the financial obligation to indemnify at $492,525. The Agreement also required, among other things, that SSC pay approximately $1 million in exchange for 67 percent of outstanding Kerma stock, that SSC contribute additional capital to Kerma over the course of the following two years, and that SSC share with Shieh any profits from Kerma's operation.

Not long after the Agreement took effect and SSC had purchased the Kerma shares, SSC conducted an internal audit of the company and discovered that Kerma's liabilities were even greater than the pre-Agreement audit had revealed. Soon thereafter, the Chinese authorities demanded the unpaid taxes, social insurance costs, and customs fees (which amounted to almost $1 million). The obsolete inventory allegedly had to be written down by approximately $405,000. SSC approached PacificLink and Shieh, requesting indemnification, and was refused.

After filing suit, SSC did not make the further capital contributions or profit distributions called for in the Agreement. Shieh and PacificLink asserted counterclaims against SSC, including claims for these contributions and distributions. Both SSC and the defendants moved for summary judgment. The district court granted SSC's motion and denied defendants' in a memorandum and order dated December 10, 2003. The judge found that PacificLink was indeed obligated to indemnify under the Agreement, and that the damages exceeded the indemnification cap of $492,525 established in the Agreement. Defendants moved for reargument and modification of the final judgment, arguing, among other things, that Shieh should not have been held liable, since only PacificLink, as the "seller" under the Agreement, was contractually liable for indemnification. The district court denied the motion, concluding that Shieh was a seller in his individual capacity and was also the alter ego of PacificLink.

The district court found that the indemnification provision was breached. Defendants argued that a section of the contract, which provides for indemnification arising out of "any liability not disclosed by the balance sheets or other financial record of Kerma," was too ambiguous (as indicated by the parties' conflicting interpretations) to make summary judgment proper. The appellate court agreed that the indemnification clause was not a model of clarity, since some of Kerma's financial records (those prepared for the benefit of the Chinese authorities) did not disclose Kerma's liabilities, while some of Kerma's liabilities were disclosed in some of the financial records maintained internally by the company. However, the court noted that some of Kerma's liabilities were undisputedly not disclosed on any balance sheet, and were only revealed by the audit. Further, the court stated that it was not disputable that the indemnification provision was added to the Agreement to address SSC's concern about all of the liabilities disclosed in the audit. Moreover, a subsection of the indemnification provision unmistakably expressed the parties' intent to provide indemnification even against liabilities of which SSC had actual or constructive knowledge. According to the appellate court, all of the evidence plainly indicated that the parties intended SSC to be indemnified in the event that the financial statements prepared for the benefit of the Chinese authorities turned out to misrepresent Kerma's actual liabilities–the precise event that came to pass. Accordingly, the appellate court affirmed the district court's finding that the indemnification provision was breached.

The district court also held Shieh and PacificLink jointly and severally liable. Defendants argued that this was error because the indemnification provision expressly obligated only "seller," which was defined elsewhere in the Agreement as PacificLink. However, the appellate court agreed with the district court's conclusion. According to the appellate court, the record revealed multiple instances in the pleadings in which defendants admitted that *both* Shieh and PacificLink had agreed to indemnify SSC against certain liabilities, and in which defendants asserted the liability of SSC toward Shieh as a "seller." In light of defendants' repeated admissions in the pleadings, and the clear litigation position taken, the appellate court concluded that it would be manifest injustice *not* to hold Shieh personally responsible for acts he performed on behalf of a company over which he plainly exercised plenary control. Accordingly, the appellate court affirmed the district court's holding on joint and several liability. *Schwan-Stabilo Cosmetics GmbH & Co. v. PacificLink Intern. Corp.*, 401 F.3d 28 (2nd Cir. 2005).

TRADEMARK LAW

Prior Foreign Registration Did Not Excuse Seller From Requirement That Mere Surnames Had To Have Acquired Distinctiveness In Order To Be Registerable

Dr. Matthias Rath (Rath) appealed from the decisions of the Trademark Trial and Appeal Board (the Board), affirming the United States Patent and Trademark Office's (PTO) refusal to register the marks "DR. RATH" and "RATH" ("the marks") on the principal register. Rath is a German citizen who applied to register the marks for goods and services including, *inter alia*, nutritional supplements, books, grains, and educational services. The applications were based upon ownership of a German trademark registration for the marks. The examiner refused to register the marks because the examiner found the marks to be primarily merely surnames. Section 2(e)(4) of the Lanham Act bars such marks from registration on the principal register.

On appeal to the Board, the marks were again found to be primarily merely surnames, and therefore not registerable on the principal register under section 2(e)(4) of the Lanham Act, absent proof of acquired distinctiveness. The Board rejected Rath's argument that the "primarily merely a surname" rule conflicts with the United States' obligations under the Paris Convention, and therefore cannot be relied upon by the PTO to refuse a foreign applicant registration of a mark already registered in his country of origin. The Board also held that section 44 of the Lanham Act, which implements the Paris Convention, does not require registration of a mark that is primarily merely a surname.

Rath argued that the surname rule was at odds with the Paris Convention as applied to those holding foreign registrations. Rath invoked article 6quinquies of the Paris Convention, which addresses the protection of marks registered in one member country in other member countries. It states in pertinent part: "A(1) Every trademark duly registered in the country of origin shall be accepted for filing and protected as is in the other countries of the Union, subject to the reservations indicated in this Article. Such countries may, before proceeding to final registration, require the production of a certificate of registration in the country of origin, issued by the competent authority. No authentication shall be required for this certificate."

Rath argued that he is exempt from the surname rule because it did not fall within any of the three enumerated exceptions to the registration of foreign marks within the Paris Convention, and he was therefore entitled to registration of his mark on the principal register. The PTO urged that surname marks are descriptive, and therefore "devoid of any distinctive character" within the meaning of the Paris Convention, such that no conflict existed between the requirements of the Lanham Act and the Paris Convention.

The court stated that it need not decide whether the surname rule conflicted with the Paris Convention because it found that the Paris Convention was not a self-executing treaty and requires congressional implementation. According to the court, it was well established that executory treaties (those treaties that are not self-executing) have no direct effect until implemented by domestic law. In addition, the court stated that the Paris Convention itself suggested that it was not self-executing. Article 25 states that "[a]ny country party to this Convention undertakes to adopt, in accordance with its constitution, the measures necessary to ensure the application of this Convention" and that "[i]t is understood that, at the time a country deposits its instrument of ratification or accession, it will be in a position under its domestic law to give effect to the provisions of this Convention." The court noted that the majority of other Courts of Appeals that have considered the issue have also held that the Paris Convention is not self-executing.

Rath alternatively argued that section 44(e) of the Lanham Act was congressional legislation implementing the Paris Convention, and that section 44(e) itself requires registration because the Paris Convention requires registration. Section 44(e) of the Lanham Act provides: "Registration on principal or supplemental register; copy of foreign registration.–A mark duly registered in the country of origin of the foreign applicant may be registered on the principal register *if eligible*, otherwise on the supplemental register herein provided. Such applicant shall submit, within such time period as may be prescribed by the Director, a certification or a certified copy of the registration in the county of origin of the applicant. The application must state the applicant's bona fide intention to use the mark in commerce, but use in commerce shall not be required prior to registration."

The court stated that section 44(e) was not susceptible to a construction that the surname rule was overcome where there had been an earlier foreign registration. According to the court, Congress did not simply adopt language incorporating the requirements of the convention in the Lanham Act. Rather it provided for registration of a foreign mark "if eligible." A mark is not "eligible" for registration on the principal register under the statute unless it satisfies the section 2 requirements, including the surname rule. According to the court, there was no question but that Congress generally intended section 44 of the Lanham Act to implement the Paris Convention. Overall, the court stated that there was simply no way to read this legislative history of the Lanham Act as suggesting that Congress intended to require registration on the principal register despite United States eligibility requirements. If anything, the history confirmed that the principal register was available to foreign registrants and United States citizens on equal terms–both had to meet the eligibility requirements of United States law. Therefore, the court concluded that while section 44(e), like section 44(d), affects United States priority or prior use rules, it was impossible to read section 44(e) to require the registration of foreign marks that fail to meet United States requirements for eligibility, because section 44 applications are subject to the section 2 bars to registration, of which the surname rule is one. The court, therefore, affirmed the Board's decision. *In re: Rath*, 402 F.3d 1207 (Fed. Cir. 2005).

INTERNATIONAL TRADE

Bureau of Customs and Border Protection's Policy Of Requiring Importers To Post At Least 100% Of Bond Was Reasonable

In *Carolina Tobacco Co. v. Bureau of Customs and Border Protection*, 402 F.3d 1345 (Fed. Cir. 2005), Carolina Tobacco Company (Carolina) manufactured and imported "value priced" cigarettes since 1998, and had a continuous entry bond in place since early 1999. Such a bond permits an importer to continuously enter merchandise and pay the duties, taxes and fees owed upon a number of entries at a later date. The bond thus secures against revenue loss for what is, in effect, an interest-free line of credit the importer has with the government during the period between entry and payment.

Carolina paid its customs duties and taxes weekly by electronic funds transfer, and never had any unpaid, underpaid, or incorrectly paid duties or taxes. Customs originally set Carolina's bond at $80,000, based on Carolina's statement that in 1999-2000 it expected to make dutiable entries totaling $500,000 and duty-free entries totaling $5,000,000. Carolina's imported tobacco products increased to $8.2 million in 2000-2001, and $13.8 million in 2001-2002. Although Customs regulations require an importer to update its continuous bond application within 30 days "whenever there is a significant change" in the information provided in its previous application, Carolina never updated its bond application to reflect the significantly increasing value of its imports and the corresponding increases in its duty and tax liability.

In late 2002, Customs notified Carolina that its continuous entry bond of $80,000 had been "determined to be inadequate to ensure compliance with Customs law and regulations," and that within 60 days Carolina must either terminate it and replace it with a $3,000,000 bond, or submit a single transaction bond and deposit estimated duties with each entry. Carolina then sought to negotiate a lower bond based on its particular circumstances including excellent payment history, weekly payment schedule, value of available inventory, and other factors that it contended reduced the risk of revenue loss. However, Carolina's attempts to negotiate a lower bond with Customs were unsuccessful. In rejecting Carolina's request for a reduced bond "after extensive deliberation of this issue," Customs stated that it "based its analysis on a number of factors, including, but not limited to the imported merchandise and associated risk assessment, industry standards, Carolina's past and anticipated import values and the equitable expectations and treatment of all importers in this industry."

Carolina then filed suit in the Court of International Trade to enjoin Customs from requiring it to replace its existing bond with a bond of more than $80,000 "without considering the factors specified in 19 C.F.R. §113.13" (discussed below) and "from demanding that [it] procure a new continuous bond in an amount in excess of an amount reasonably necessary to ensure [its] compliance with applicable customs laws and regulations." Carolina claimed that Customs "failed to consider the factors specified by 19 C.F.R. §113.13 and appears to have applied general guidelines rather than consider facts specific to Carolina," that "a continuous bond of $3,000,000 far exceeds the amount necessary to ensure Carolina's compliance with applicable customs laws and regulations," and that the bond increase was "unreasonable, arbitrary, capricious, an abuse of discretion, and otherwise not in accordance with law."

The Court of International Trade granted Customs' motion for judgment on the administrative record. As the court pointed out, Carolina's basic argument was that Customs, by applying its internal directive (also discussed below) that bonds should be set to at least 10 percent of the amount of the duties, taxes and fees paid by the importer in the previous year, violated the requirement in the regulatory guidelines that Customs should consider six specified factors when setting bond. Carolina argued that the regulation of 19 C.F.R. §113.13(b) "mandated an individualized assessment of each importer and its activity rather than application of a generalized formula."

In rejecting this argument, the court stated: "Although the guidelines set forth by 19 C.F.R. §113.13 and the instructions contained in Customs Directive 99-3510-04 appear to contemplate different schemes for establishing an importer's bond requirement, the methodologies are not necessarily inconsistent. The Court is satisfied with Customs' explanation that, due to the lag time before it could stop an importer from withdrawing merchandise for consumption, a 10 percent bond is a necessary minimum amount of protection for the revenue. Moreover, the Court finds reasonable Customs' explanation at oral argument of the interplay between the Directive and the Regulation, namely that the 10 percent bond is required when the importer has a favorable review under 19 C.F.R. §113.13 and an even higher bond would be required if analysis under these guidelines indicated that the importer posed a greater risk to the revenue."

Carolina's case turned on the interpretation and interrelationship of two sets of "guidelines" promulgated by Customs covering its determination of the amount of importers' bonds. The first, adopted as a formal regulation following notice and opportunity for comment, provides the following: "(b) Guidelines for determining amount of bond. In determining whether the amount of a bond is sufficient, the port director...should at least consider: (1) The prior record of the principal in timely payment of duties, taxes, and charges with respect to the transaction(s) involving such payments; (2) The prior record of the principal in complying with Customs demands for redelivery, the obligation to hold unexamined merchandise intact, and other requirements relating to enforcement and administration of Customs and other laws and regulations; (3) The value and nature of the merchandise involved in the transaction(s) to be secured; (4) The degree and type of supervision that Customs will exercise over the transaction(s); (5) The prior record of the principal in honoring bond commitments, including the payment of liquidated damages; and (6) Any additional information contained in any application." 19 C.F.R. §113.13(b) (1999).

Prior to promulgating this regulation, Customs received requests during the notice and comment period that it codify a consistent bond formula, and explained that it would do so by issuing directives. Indeed, Customs noted that "virtually every commenter expressed concern with the provisions of proposed §113.13(b) relating to guidelines for determining the amount of the bond. Based upon the commenters' concerns, Customs will formulate specific guidelines to be used in conjunction with those set forth in proposed §113.13(b)." Customs then issued an internal directive, Customs Directive 99-3510-004, *Monetary Guidelines for Setting Bond Amounts* (issued July 23, 1991) (the "Directive"). The Directive, stated in pertinent part, the following: "Guidelines for Determining Amounts of Bonds: Activity 1–Importer or Broker—Continuous–. The bond limit of liability amount shall be fixed in an amount the district director may deem necessary to accomplish the purpose for which the bond is given. The non-discretionary bond amount minimum is $50,000. To assist the district director in fixing the limit of liability amount, the following formula shall be used. None to $1,000,000 duties and taxes–the bond limit of liability amount shall be fixed in multiples of $10,000 nearest to 10 percent of duties, taxes and fees paid by the importer or broker acting as importer of record during the calendar year preceding the date of the application. Over $1,000,000 duties and taxes–the bond limit of liability amount shall be fixed in multiples of $100,000 nearest to 10 percent of duties, taxes and fees paid by an importer or broker acting as importer of record during the calendar year preceding the date of the application. In either of these two categories a bond may be demanded with a limit of liability amount greater than that computed using this formula, provided sufficient evidence of high risk is on-hand to support the higher amount."

Carolina contended that by adopting the six specific "Guidelines for determining the amount of bond," the Section 113.13(b) regulation required Customs to base the amount of the bond upon "an individualized assessment" of the situation of each particular importer, and that Customs' use of the 10 percent minimum specified in its internal Directive was invalid because it was inconsistent with the regulation's guidelines. Except for this contention, Carolina did not challenge Customs' authority to adopt a numerical formula for the minimum amount of bonds. However, the court noted that Carolina's argument had several fatal flaws. First, according to the court, the Section 113.13(b) regulation provides "Guidelines for determining amount of bond." Guidelines are just that. They provide suggested standards for government officials to use in performing their duties. They do not impose explicit requirements, but merely indicate appropriate courses for the officials to follow.

Second, since both the Section 113.13(b) regulation and the Directive were promulgated by Customs, the court noted that it was appropriate to consider that agency's intent and purpose in adopting them. According to the court, there was nothing in the language or history of those provisions that even suggested, let alone established, that Customs intended them to require the kind of "individualized assessment" of a particular importer's situation that Carolina interpreted the regulation to require. According to the court, this approach was consistent with Customs' indication, prior to promulgating the regulation, that it had been asked to provide a consistent bond formula and that it would do so through directives. It also was consistent with the language of the regulation that the port director should consider the factors "in determining whether the amount of a bond is sufficient." Because an agency's interpretation of its own regulations is entitled to broad deference from the courts, this court saw no reason to reject Customs' interpretation of its own regulation.

Third, the court noted that even if the Section 113.13(b) regulation required some individualized consideration by Customs of the six factors before setting the amount of the bond, Carolina did not show that Customs failed to give such consideration in this case. The regulation states that "in determining whether the amount of a bond is sufficient," the port director "should at least consider" the six factors. The statement that the director should "consider" the factors, according to the court, implied wide areas of judgment and, therefore, discretion. In considering the factors, the court found the port director may give them whatever weight he deems appropriate, including no weight whatsoever to a particular factor.

In this matter, the court determined that Carolina did not carry its burden, finding that the failure of Customs to explicitly discuss the six factors when it initially increased Carolina's bond did not establish that it did not consider them. Indeed, in its first letter explaining why it would not reduce the amount of the increased bond, Customs stated that it based its analysis "on a number of factors," several of which included the factors listed in the regulation. Customs thus did consider Carolina's particular situation before its decision to increase the bond finally became operative. Therefore, the court affirmed the judgment of the Court of International Trade. *Carolina Tobacco Co. v. Bureau of Customs and Border Protection*, 402 F.3d 1345 (Fed. Cir. 2005).

FORUM NON CONVENIENS AND INTERNATIONAL COMITY

After Applying Balancing Test and Giving Some Deference To Plaintiff's Forum Choice, Motion To Dismiss For Forum Non Conveniens and International Comity Denied

In one of potentially thousands of products liability actions arising out of Defendant St. Jude Medical, Inc.'s (SJM) manufacture, design, marketing and sale of a heart valve with Silzone materials, SJM filed motions to dismiss Plaintiff Shane O'Neill's lawsuit on grounds of *forum non conveniens* and international comity. SJM is a Minnesota company with headquarters and manufacturing facilities in Ramsey County, Minnesota. The United States Food and Drug Administration approved the subject valve in March of 1998. Approximately 36,000 of the valves have been implanted worldwide since then. O'Neill was implanted with this valve in early 1998. He suffered a paravalvular leak and the valve had to be explanted in December 1998. He received a second Silzone valve after explantation and still had that valve in his body.

In early 2000, SJM voluntarily withdrew these valves from the market, instructed hospitals and physicians not to use Silzone products, sent letters regarding the care and management of patients who had the valves, and established a reimbursement program to pay for medical costs of patients for detection, diagnosis, and treatment of Silzone valve patients with paravalvular leaks. The recall decision was made after the AVERT independent monitoring board reported that recipients of Silzone valves were more likely to suffer these leaks than recipients of non-Silzone valves. The AVERT study (Artificial Valve Endocarditis Reduction Trial) was a multinational clinical trial sponsored by SJM to find out whether SJM's belief that Silzone would reduce the incidence of endocarditis in heart valve patients. Since the recall, increasing numbers of lawsuits have been filed in federal and state courts in the United States as well as in numerous foreign countries. The O'Neill case was filed in Ramsey County District Court. The case was removed to federal court, and then remanded to state court shortly thereafter.

On remand, SJM argued that a plaintiff who is a resident of a foreign country is not entitled to the same deference in choice of forum, as a resident of the United States. However, the court noted that the general rule is that, unless the balance is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed. In this case, almost all of O'Neill's claims involve allegations of actions and omissions by SJM itself in Minnesota. The Silzone valves were designed, researched, developed, engineered, tested, manufactured, quality-controlled, marketed and distributed from Ramsey County, Minnesota. The labels, warnings and instructions for the valves were drafted there. In addition, the majority of witnesses and documents necessary to establish the SJM's liability are located in Minnesota. O'Neill chose Ramsey County as the forum to proceed against SJM.

The court also stated that Minnesota was a convenient forum for the plaintiffs to try most of their claims in this case and it did not find that Minnesota is less convenient than Europe, because the case could be adequately tried in Europe. Other plaintiffs had already chosen to file their Silzone claims in European countries. Overall, the court stated that SJM bears the burden of persuasion in proving all of the necessary elements to reject the plaintiff's choice of forum and to dismiss a claim based on *forum non conveniens*. After balancing the public and private interests involved and giving some deference to the plaintiff's choice, the court denied SJM's motion to dismiss for *forum non conveniens*.

In addition, the court noted that the federal judge who received this case after it was removed to federal court, Judge Tunheim, found any impact on the United States' relations with Europe or its individual nations too speculative and tenuous to find federal jurisdiction over this case. The state court, therefore, also found any impact on the United States' relations with Europe or its individual nations too speculative and tenuous at that stage to dismiss the suit on comity grounds. The materials submitted by SJM regarding formal questions by members of parliament to the Health Minister regarding Silzone valves in the United Kingdom evince a concern but could not be compared to the objections raised by the government of Ecuador in a similar matter, where Ecuador had officially protested the lawsuit, asserting that it would do violence to the international legal system and requested that the case be dismissed. The court also stated that the objections raised could not be compared to those involving the government of Peru in another matter, which expressed strenuous objection to the exercise of jurisdiction by the U.S. Federal Court. The court noted that both of those cases involved the natural resources of the foreign country. Accordingly, the court held that SJM's arguments failed to convince the court that its motion to dismiss on grounds of comity should be granted. *O'Neill v. St. Jude Medical, Inc.*, 2005 WL 1114469 (Minn.Dist.Ct. 2005).