



CHAPTER 1

Introduction to International Business

INTRODUCTION

Today most people agree that no business is purely domestic and that global competition and world events affect even the smallest local firms. The realities of the modern world make all business international. No longer can an economic or a political change in one country occur without reverberations throughout world markets. A tsunami in Asia interrupts global supply chains and brings distant assembly lines to a halt. War in the Middle East brings international shipping to a crawl. Contagious disease in Hong Kong or Toronto slows international business travel. The failure of China to safeguard American copyrights on films or software results in the United States imposing retaliatory tariffs and affects the price of Chinese-made clothing in American stores. Terrorist attacks not only affect business operations worldwide but also affect the ability of managers to travel and live safely in foreign lands.

As countries lower entry barriers to foreign goods and services, more and more foreign goods now appear in local stores around the world. Brand names once recognized only at home are now global brand images. And giant multinational corporations now move people, money, and technology across national borders in the blink of an eye. Clearly, no firm can remain isolated from international forces for long. As you will see in this chapter, just as national economies have become more interdependent, and businesses more globalized, so too has business law become more international. Our goal in this chapter is to explain the forms of international business, to explore the risks of international business transactions, and to set the stage to learn how international business law can be a tool to help manage these risks.

FORMS OF INTERNATIONAL BUSINESS

This text classifies international business into three categories: (1) trade, (2) protection and licensing of intellectual property (IP), and (3) foreign direct investment.

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To the marketer, these broad categories describe three ways a firm may enter a foreign market, or foreign market entry methods. To the international lawyer, they represent three forms of doing business in a foreign country and the legal relationship between parties to an international business transaction. Each form represents a different level of commitment to a foreign market, a different level of involvement in the life of a foreign country, and a different set of managerial challenges. Each form exposes firms to different sets of business and legal risks. Trade usually represents the least involvement, and thus the least political, economic, and legal risk; we buy or sell goods or services to others in foreign countries. A firm that wants to use its intellectual property worldwide must first protect it from infringement, and then contract to let others distribute it or license it to users. . However, the greatest risks come with the full or partial ownership and operation of a foreign firm, perhaps a factory. This carries with it the obligations of corporate citizenship and means the complete involvement in all aspects of life in the foreign country—economic, political, social, cultural, and legal.

The three forms in international business are not mutually exclusive, and each can play a role in an international firm's strategy. One of the best examples is the vertically integrated firm that holds minority or majority ownership interest in other firms along the supply chain. One firm may be engaged in production of raw materials or component parts, which are exported to an affiliated company in another country for final assembly. Still another company, owned by the same parent corporation, may own the trademark for the product and have responsibility for global distribution. Here the production and marketing of a single product involves elements of trade, licensing, and investment. For firms just entering a new foreign market, the method of entry might depend on a host of considerations, including the sophistication of the firm, its overseas experience, the nature of its products or services, its commitment of capital resources, and the amount of risk it is willing to bear.

Trade

Trade is the import or export of goods and services across national borders, usually as part of an exchange. **Exporting** is the shipment of goods out of a country or the rendering of services to a buyer located in a foreign country. **Importing** is the entering of goods into the customs territory of a country or the receipt of services from a foreign provider. **Trade in services** refers to the providing of services to a customer or the operation of service companies in a foreign country. Examples can be found in transportation, package delivery, banking, insurance, securities brokerage, law, accounting, architecture, waste management, environmental engineering, software development, and management consulting.

Exporting. Exporting is often a firm's first step into international business. Compared to the other forms of international business, exporting is relatively uncomplicated. It may provide the inexperienced or smaller firm with an opportunity to reach new customers and to tap new markets. It usually requires only a modest capital investment, and the risks are generally manageable by most firms. It also permits a firm to explore its foreign market potential before venturing further. For many larger firms, including multinational corporations, exporting may be an important portion of their business operations. The U.S. aircraft industry, for example, relies heavily on exports for significant revenues.

Direct exporting refers to a type of exporting in which the exporter, often a manufacturer, assumes responsibility for most of the export functions, including marketing, export licensing, shipping, and collecting payment. Many firms engaged in direct exporting on a regular basis reach the point at which they must hire their own full-time export managers and international sales specialists. These people participate in making export marketing decisions, including product development, pricing, packaging, and labeling for export. They should take primary responsibility for dealing with foreign buyers, attending foreign trade shows, complying with government export and import regulations, shipping, and handling the movement of goods and money in the transaction. Many direct exporters use the services of foreign sales representatives or foreign distributors.

Foreign sales representatives are independent sales agents who solicit orders on behalf of their principals and receive compensation on a commission basis. They have the advantage of knowing the foreign

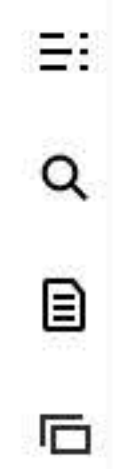
market, having established customer loyalty, and carrying a range of complementary products. For instance, one agent may represent several different manufacturers of U.S. sporting goods in Japan—one that makes baseball bats, another that makes gloves, and a third that makes baseballs.

Foreign distributors are independent firms, usually located in the country or region to which a firm is exporting, that purchase and take delivery of goods for resale to their customers. Exporters use foreign distributors when their products require service or a local supply of spare parts or if they are perishable or seasonal. Foreign distributors assume the risks of buying and warehousing goods in their markets and provide additional product support services. The distributor usually services the products they sell, thus relieving the exporter of that responsibility. They often train the end users of the products, extend credit to their customers, and bear responsibility for local advertising and promotion.

Companies that do not have the experience, personnel, or capital to tackle a foreign market alone frequently use indirect exporting. The term **indirect exporting** refers to a firm's use of specialized intermediaries outside of their own organization to handle specific functions—foreign marketing, foreign sales, finance, and shipping are examples. This is usually done when smaller or medium-sized companies do not have a dedicated international sales staff or export department or are not yet ready to handle the mechanics of export transactions on their own. Two types of intermediaries include international or export trading companies and export management companies.

International Trading Companies. These are firms that specialize in all aspects of import/export transactions either by buying goods on their own accounts for resale or by acting as middlemen to bring other buyers and sellers together. Many trading companies handle particular types of goods, such as commodities, energy, minerals and metals, or general merchandise. They can be as small as one individual or a sprawling multinational corporation. They come from both developed and developing countries. They have extensive sales contacts overseas and experience in international finance, air and ocean shipping, preparing legal documents for import and export, and dealing with customs authorities in many countries.

Japanese trading companies (called *sogo shosha*) are well known for their successes worldwide. Their early



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advantage over trading companies in the United States was their ability to bring together many competing producers in the Japanese market to take advantage of economies of scale in exporting. For example, a trading company might bring together several makers of competing large appliances and coordinate pricing and distribution in foreign countries. This proved to be very effective for the Japanese.

In the United States, until 1982, any collusion by competitors to fix prices and market jointly would have been considered a violation of the U.S. antitrust laws. In that year, the U.S. Congress passed the *Export Trading Company Act*, giving American exporters the same competitive advantage as the Japanese. U.S. **export trading companies**, or ETCs, can apply for and receive an **Export Trade Certificate of Review** from the U.S. Department of Commerce, with the approval of the Department of Justice, that waives the application of U.S. antitrust laws to their specified export activities. For example, it is illegal for two competing firms that manufacture similar products to agree to fix prices in the U.S. market. However, if both companies are members of an approved ETC, they may jointly establish export prices, enter into joint export marketing arrangements, allocate export territories, and do business in ways that would be illegal if done with the U.S. market. The waiver is issued only if it is shown that the

advantage will not lessen competition within the United States, or unreasonably affect domestic prices of the exported products. There are many other advantages in selling through an ETC, such as teaming up to bid on large foreign projects, filling large and complex foreign orders, joint marketing of complementary or competing products, division of foreign territories by competing firms, sharing of marketing and distribution costs, and reducing rivalry between U.S. firms in dealing with foreign customers.

The following case, *Tarbert Trading v. Cometals*, involves two trading companies (not U.S. ETCs) were apparently overly anxious to make the sale and a fraudulent certificate of origin—one of the most important legal documents used in import/export transactions. A **certificate of origin** (CO) is a document, prepared or provided by an exporter or shipper, that certifies and attests to the country of origin of the goods being shipped. A CO is required by customs authorities of the importing country. Some certificates must be in the legal form required, such as those used in the European Union, or for goods being shipped within a free-trade area. Some countries require that the CO be certified by an outside organization or foreign consulate office of the importing country. Frequently, the certificate may be a more informal certification made and signed on the exporting company's letterhead.



Tarbert Trading, Ltd. v. Cometals, Inc.

663 F. Supp. 561 (1987) United States District Court (S.D.N.Y.)

BACKGROUND AND FACTS

Cometals, a New York commodities trading corporation, purchased 2,000 tons of Kenyan red beans from Tarbert Trading, an English commodities trading company. The beans would be shipped from a warehouse in Rotterdam, the Netherlands. Cometals purchased the beans for "back to back" resale to a buyer in Colombia. However, the government of Colombia required a certificate of origin issued by a Chamber of Commerce showing that the beans were a product of the European Economic Community (EEC, now the European Union). Cometals requested that Tarbert supply such a certificate and Tarbert agreed. Employees of the two firms collaborated on the wording of the certificate even though they understood that Kenyan red beans originated in Africa. Later, Cometals refused the beans due to insect damage and Tarbert sued. Cometals maintained that the agreement should be declared void because Tarbert could not, except

through fraud, have supplied an EEC certificate of origin for Kenyan red beans. Tarbert later resold the beans to the original seller.

NEWMAN, SENIOR JUDGE

Concededly, both Tarbert and Cometals were cognizant of the fact that an EEC certificate of origin stating that the Kenyan beans were of the origin of an EEC member would be false and would be shown to third persons. * * * Simply put, [Cometals] intended to deceive the Colombian customs officials with a false certificate as to the beans' country-of-origin so that they would allow the importation of the beans by Cometals' customer.

Irrespective of the rather incredible explanations of [Tarbert's employees] as to what they understood to be the purport of the requested certificate of origin, they finally and grudgingly conceded that an EEC certificate stating that the goods were of the origin of an EEC member would be understood by anyone reading it to

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mean that the beans were grown in an EEC country and not simply shipped from such country. * * *

It is evident from the Kenyan origin of the beans that it would have been impossible for Tarbert to honestly obtain from a Chamber of Commerce and furnish Cometals with a bona fide EEC certificate of origin stating that the goods were of the origin of a member of the EEC since concededly Kenya is not an EEC member. Thus, the only way in which Tarbert could have complied with the agreement would have been to convince an official of a Chamber of Commerce to issue a fraudulent certificate or to obtain a forged certificate. Both acts are obviously illegal.

"No one shall be permitted to profit by his own fraud, or take advantage of his own wrong, or to found any claim upon his own iniquity, or to acquire property by his own crime. These maxims are dictated by public policy, have their foundation in universal law administered in all civilized countries, and have nowhere been superseded by statutes." [citations omitted] * * *

Plainly, enforcement of the agreement for either party would be contrary to public policy . . .

Decision. The complaint and counterclaim were dismissed. Agreements that violate the law are void. In this case, an agreement calling for the delivery of a fraudulent certificate of origin is illegal and contrary to public policy.

Comment. Trading companies play an important role in world trade. While what happened here is obviously a rare case, it does give us an opportunity to introduce

some of the documents required in international trade and to question the legal and ethical conduct of the parties. It also teaches us the importance of knowing more about the people we do business with.

Case Questions

1. Import/export transactions usually require much more documentation than domestic transactions. These include detailed invoices, packing lists, shipping and insurance documents, and specialized certificates. In this case, a "certificate of origin" was required by the government of Columbia before the goods could be imported. Does it refer to the country from which the goods were shipped or where they were grown or made? Why do you think Columbia required a certificate of origin? What is its purpose?
2. Suppose that the beans had arrived in Columbia and were then stopped by Colombian customs authorities because of a fraudulent certificate. What do you think might have happened to the beans? What would the risk have been to Cometals and Tarbert? What if the Colombian buyer had already paid for the beans?
3. Evaluate and discuss the conduct of Cometals and Tarbert. Fraudulent documentation is not uncommon in international trade, especially when parties do not have a history of business together. What are the lessons to be learned by all parties?

Export Management Companies. Independent firms that assume a range of export-related responsibilities for manufacturers, producers, or other exporters are called **export management companies**, or EMCs. They might do as little as render advice and training on how to export, or they might assume full responsibility for the entire export sales process. Many EMCs specialize in specific industries, products, or foreign markets. Firms that cannot justify their own in-house export departments use EMCs. Researching foreign market, establishing foreign channels of distribution, exhibiting goods at foreign trade shows, working with foreign sales agents, preparing documenting for export, and handling language translations and shipping arrangements are also among the services EMCs provide.

Successful Small Business Exporting. When we think of international business, usually the largest multinational corporations come to mind. It is true that

the largest companies, those with more than 500 employees, still dominate the total share of U.S. export volume. Nevertheless, many small and medium-sized U.S. exporters (less than 500 employees) do extremely well in foreign markets. According to the U.S. Department of Commerce *Exporter Database*, for example, in 2015 there were approximately 293,000 individual companies exporting goods from the United States. Ninety-eight percent of those were small to medium-sized exporters, accounting for one-third of the total exports of goods. About one-quarter of those were manufacturers. The Department of Commerce points out that because the majority of companies ship only to one foreign country, this group as a whole could increase its export sales by entering additional foreign markets.

What does it take for a small business to be a successful exporter? First, most people agree that looking to foreign markets is not a panacea for a company's failures at home. Due to the time and resources



necessary to enter a foreign market, a firm that is already failing at home will likely be unable to bear the cost of expansion and will probably repeat its same mistakes again. Second, experience shows that success or failure in entering a foreign market is often due to the commitment made to international business at a company's executive level. Many small companies that are new to exporting may lack the global view and commitment to foreign customers of a multinational corporation. In some cases they wrongly look for new customers abroad only when the economy declines at home. But this has proven shortsighted. During the time needed to gear up for the export process, which can take months or years, the domestic economy may heat up again, domestic customers return, and the new-to-export firm may lose interest in its newfound foreign customers. Without a long-term commitment, foreign buyers view these firms as unreliable suppliers. Many small companies soon learn that entering international markets requires time, patience, and commitment. Third, many small companies learn too late that international business is not merely a distant extension of domestic business. It requires the company to adapt to a new social, cultural, political, and

economic environment and to be prepared to meet new challenges. For example, it may have to adapt its products and services to the expectations of the foreign market, develop new channels of distribution, visit foreign customers, and comply with new legal regulations, and so on. Finally, one of the greatest mistakes made by small business exporters, especially "new-to-export" firms, is the failure to have an **export plan** (see Exhibit 1.1).

Licensing and Protection of Intellectual Property Rights

The *Intellectual Property Handbook* of the World Intellectual Property Organization broadly defines **intellectual property (IP)**, also called **intellectual property rights (IPRs)**, as "legal rights which result from intellectual activity in the industrial, scientific, literary, and artistic fields." The most common forms are patents, trademarks, copyrights, and trade secrets. Patents have many different forms. In addition to the traditional patents on apparatus, they include methods for achieving a commercial objective, industrial designs, utility models, and geographical indications. The IP owner has the

Exhibit 1.1

Components of an Export Plan

- Assessing the firm's readiness for export markets and its willingness to commit financial resources, human resources, and production output to foreign customers
- Making a long-term commitment to exporting and to foreign customers on the part of senior management and executives
- Identifying foreign-market potential of the firm's products, including economic, political, cultural, religious, and other factors
- Identifying the risks involved in exporting to that foreign market, including an evaluation of cost-effective shipping arrangements, banking arrangements for getting paid, and political risks
- Evaluating the legal aspects of the firm's export plan for compliance with government rules and customs regulations, including identifying legal controls on exporting its products out of the United States as well as legal barriers to importing and selling its products in the foreign country, and whether there are any patents, copyrights, or trademarks that must be protected abroad
- Determining the export readiness and suitability of the firm's products for the export market, including whether the products meet the quality standards, technical regulations, and foreign language requirements of foreign countries and whether any redesign, reengineering, or relabeling of products is needed
- Identifying members of the "export team," comprising management, outside advisors, and trade specialists from banking, shipping, and government
- Identifying possible financing arrangements to assist foreign buyers
- Establishing foreign market channels of distribution, including deciding whether to export directly to customers or indirectly through intermediaries, deciding whether to use a sales representative or foreign distributor, identifying potential buyers, and participating in foreign trade shows
- Reevaluating the firm's export performance over time, reconsidering its export plan, and determining whether the firm should increase its penetration of foreign markets beyond exporting



right to use, reproduce, distribute, and profit from its property; to license its use or distribution to others; and to protect it from unauthorized infringement. Firms with significant IP assets must protect their legal rights in every country in which they plan to do business or even in which their patent, trademark, or copyright might be stolen, or infringed. Each country governs the recognition and protection of IP rights within its borders. In the United States, IP law is almost entirely the province of federal law, although state law does apply in some areas not covered by federal law. A large body of state contract law and tort law also applies to many cases involving IP infringement. Most countries maintain a registration system for creating and protecting rights to patents, trademarks, and copyrights. Several important IP treaties provide for streamlined procedures for mutually recognizing and enforcing IP rights. Many countries cooperate on IP policy and enforcement efforts.

International Licensing Agreements. IP is a valuable asset that can be transferred by the owner or holder to licensee through a grant of rights in that property, called a **license**. The license is usually part of a larger business arrangement represented in a licensing agreement. **Licensing agreements** are contracts by which the holder of IP will grant certain rights (the “license”) in that property to another party under specified conditions and for a specified time, in return for a consideration, such as a fee or royalty or as a part of a larger business arrangement. Licenses can be either exclusive or nonexclusive, and frequently limit distribution to a certain geographical area, to certain uses, or to a certain period of time.

In the following case, *Russian Entertainment Wholesale, Inc. v. Close-Up International, Inc.*, the court was asked to resolve a conflict between two licensees of exclusive distribution rights to Russian films in the United States.



Russian Entertainment Wholesale, Inc. v. Close-Up International, Inc.

767 F. Supp. 2d 392 (2011) United States District Court (E.D.N.Y.)

BACKGROUND AND FACTS

Two Russian film studios [the studios] granted rights to produce and distribute DVD versions of their films to multiple licensees. Each licensee received different limited exclusive rights. Krupny Plan, which could distribute the films only in the original Russian language, sublicensed its rights to the films for home use in the United States and Canada to Close-Up, a New York corporation. Ruscico could distribute multilingual versions of the same films that were dubbed or subtitled and sublicensed its rights to its distributor in the United States, Image. At the time of licensing, none of the parties considered that a viewer of the subtitled films could simply turn off the subtitles and hear the film in any of several languages, including Russian. None of the agreements had a requirement that the films prevent the disabling of subtitles. Close-Up brought this action against Ruscico and Image for damages from copyright infringement, claiming that it is the “exclusive” U.S. licensee of the Russian language-only versions of the films. The federal district court held for the defendants, and Close-Up appealed.

COGAN, DISTRICT JUDGE

The Copyright Act establishes that the “legal or beneficial owner of an exclusive right under a copyright” may bring suit for infringement under the act [citations

omitted]. However, when this provision is invoked by an exclusive licensee, the licensee may seek relief from infringement only for the rights that the licensee has been exclusively licensed by the copyright holder.

Plaintiff has shown that . . . it was the legal and beneficial licensee of the narrow right to reproduce and distribute *Russian-language-only* versions of the subject works. Therefore, even if plaintiff had a valid sublicense, plaintiff would still only have standing to sue for infringement of the narrow right to reproduce and distribute Russian-language-only DVDs. . . . * * *

The evidence presented at trial proves that [the studios] elected to grant a “Russian language-only” right to one licensee, and a separate “multilingual” right to another. The rights-holders did not consider sales of the multilingual DVDs manufactured by [the defendants] to violate the “Russian language-only” license separately given to Krupny Plan. Instead, they considered the multilingual DVDs to be a distinct line of products, geared towards the separate non-Russian-speaking market. * * *

Plaintiff has failed to put forth any evidence that defendants ever produced or distributed works that infringed plaintiff’s limited rights in Russian-language-only DVDs . . . Instead, the evidence shows that all of the DVDs produced and distributed by defendants were multilingual DVDs, which [the studios] viewed as being distinct from the Russian-language-only DVDs

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that they had authorized Krupny Plan to reproduce and distribute. Plaintiff thus has failed to make out a claim for copyright infringement against any of the defendants. * * *

Because there is no evidence that defendants reproduced or distributed DVD copies of the [films] that did not contain subtitles or dubbing in foreign languages, defendants' conduct was entirely within the scope of their rights . . .

Plaintiff next argues that paragraph 1.2.1 [of defendants' license], which states that "[r]eproduction of the Films in the original language without the accompaniment of the picture by sound and/or subtitles in a foreign language is a violation of the present Agreement," should be interpreted to mean that production of DVDs that *could be watched* in Russian without subtitles or dubbing was a violation of the agreement. However, plaintiff reads too much into this provision, which explicitly states that its purpose was to ensure that the DVDs produced by [the defendants] would be "multilingual versions." In this context, it is clear that paragraph 1.2.1 simply forbade [the defendants] from producing DVD copies . . . that did not include foreign subtitles or dubbing accompanying the films. Because all of the DVDs produced by defendants were multilingual versions that included subtitles in numerous foreign languages, defendants did not violate this provision of the

agreement by producing DVDs that did not contain a disabling feature. * * *

Decision. Judgment affirmed for the defendant. A licensee of a limited exclusive license may seek relief from infringement only for the exclusive rights received from the copyright holder. Here, the plaintiff received only the rights to reproduce or distribute Russian-language-only DVDs. Defendants, pursuant to their license, distributed only multilingual (dubbed) versions and versions with subtitles.

Case Questions

1. What are the "limited exclusive" rights granted to the licensees in this case?
2. What is the difference between the rights granted to the plaintiff and those granted to the defendants?
3. Do you agree or disagree with the court's interpretation of the license agreements?
4. What does this case tell you about negotiating and drafting a licensing agreement?

Case Comment

The district court's opinion was affirmed in *Russian Entertainment Wholesale, Inc. v. Close-Up International, Inc.*, 482 Fed. Appx. 602 (2d Cir. 2012).

International Organizations and IP. The most important international IP organization is the World Intellectual Property Organization, or WIPO, a specialized agency of the United Nations, headquartered at Geneva. It was established in 1967 and currently has 185 member countries. WIPO fosters government cooperation in developing IP policies and coordinates registrations in some IP areas. It administers an arbitration center to resolve IP disputes between private parties, such as individual inventors, corporations, and universities (including patent, trademark, industrial design, and domain name dispute resolution). Another organization, the World Trade Organization (WTO), helps member countries assure a more uniform application and enforcement of their national IP laws. Its Dispute Settlement Body is a forum for resolving IP disputes between governments.

Infringement, Piracy, or Counterfeiting. The term **infringement** refers to the violation of the IP rights of another, and often occurs in the unauthorized use, distribution, or appropriation of those rights.

IP infringement is often referred to as piracy or counterfeiting.

Intellectual property rights are the reward for innovation. Without laws to protect IP, and without the ability to enforce those laws, innovation in the arts, sciences, and industry would be destroyed. Thus enforcement of IP rights is a worldwide effort. However, many countries find it difficult to prevent IP piracy. Some developing countries have even encouraged it because of the perceived financial gains to their economies. For example, a few developing countries have not protected pharmaceutical and chemical patents, believing that some products are so indispensable to the public that low-cost generic versions should be encouraged regardless of the IP rights of the inventor. Ecommerce and mobile technologies have magnified the problem, not just in the sale of goods, but in many areas, such as the retransmission of performances, sports events, and films. Reports of the Office of the U.S. Trade Representative highlight the lack of enforcement of IP laws in China, India, Indonesia, Russia, Ukraine, and Venezuela, and many others.



Transfer of Technology. The sharing of scientific information, technology, and manufacturing know-how between firms, universities, or other institutions is known as the **transfer of technology**. It is important to building business alliances and is often accomplished through complex licensing agreements that include patent and other forms of IP.

International Franchising. **Franchising** is a business arrangement that uses an agreement to license, control, and protect the use of the franchisor's patents, trademarks, copyrights, or business know-how, combined with a proven plan of business operation in return for royalties, fees, or commissions. The most common form of franchising is known as a business operations franchise and is usually used in retailing. Under a typical franchising agreement, the franchisee is allowed to use a trade name or trademark in offering goods or services to the public in return for a royalty based on a percentage of sales or other fee structure. The franchisee usually obtains the franchisor's rules for operating and managing the enterprise, along with the brand and other trademarks to attract customers. Franchising in the United States accounts for a large proportion of total retail sales. When American markets became saturated for franchise opportunities several decades ago, U.S. firms began looking for growth overseas. As in the United States, foreign franchising has been successful in fast-food retailing, hotels, car rental, automobile maintenance, educational courses, convenience stores, printing services, and real estate services, to name a few. U.S. firms have excelled in franchising overseas, making up the majority of new franchise operations worldwide. The prospects for future growth in foreign markets

are enormous, especially in China and the developing countries of Asia, the Middle East, and Latin America.

Some Legal Aspects of Franchising. Franchising is a good vehicle for entering a foreign market because the local franchisee provides capital investment, entrepreneurial commitment, and on-site management to deal with local issues, such as labor and employment. However, franchisors face many legal requirements. Franchising in the United States is regulated primarily by the Federal Trade Commission at the federal level, which requires the filing of extensive disclosure statements to protect prospective investors. Other countries have also enacted franchise disclosure laws. Some developing countries have restrictions on the amount of money the franchisor can remove from the country and others might have restrictions on importing supplies (ketchup, paper products, etc.) for the operation of the business. While these restrictions protect local suppliers, more progressive developing countries are now abandoning them because they recognize that foreign franchises bring high-quality consumer products and managerial talent to their countries. Having eliminated many of its restrictions on franchising in recent years, franchises in China today are governed by a 2007 law and are subject to approval by the China Ministry of Commerce.

The following case, *Dayan v. McDonald's*, illustrates the difficulty in supervising the operations of a franchisee in a foreign country. Consider how any U.S. franchiser will allow its franchisees to adapt to the cultural environment in a foreign country while still providing the same consistent quality and service that is expected whenever anyone patronizes one of its establishments anywhere in the world.



Dayan v. McDonald's Corp.

125 Ill. App.3d 972, 466 N.E.2d 958 (1984) Appellate Court of Illinois

BACKGROUND AND FACTS

Dayan received an exclusive franchise to operate McDonald's restaurants in Paris, France. The franchise agreement required that the franchise meet all quality, service, and cleanliness (QSC) standards set by McDonald's. The agreement stated that the rationale for maintaining QSC standards was that a "departure of restaurants anywhere in the world from these standards impedes the successful operation of restaurants throughout the world, and injures the value of [McDonald's] patents, trademarks, trade name, and property." Dayan agreed not to vary from QSC standards without

prior written approval. After several years of quality and cleanliness violations, McDonald's sought to terminate the franchise. Dayan brought this action to enjoin the termination. The lower court found that good cause existed for the termination and Dayan appealed.

BUCKLEY, PRESIDING JUSTICE

Dayan also argues that McDonald's was obligated to provide him with the operational assistance necessary to enable him to meet the QSC standards.

... Dayan verbally asked Sollars (a McDonald's manager) for a French-speaking operations person

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to work in the market for six months. Sollars testified that he told Dayan it would be difficult to find someone with the appropriate background that spoke French but that McDonald's could immediately send him an English-speaking operations man. Sollars further testified that this idea was summarily rejected by Dayan as unworkable even though he had informed Dayan that sending operations personnel who did not speak the language to a foreign country was very common and very successful in McDonald's international system. Nonetheless, Sollars agreed to attempt to locate a qualified person with the requisite language skills for Dayan.

Through Sollars's efforts, Dayan was put in contact with Michael Maycock, a person with McDonald's managerial and operational experience who spoke French. Dayan testified that he hired Maycock sometime in October 1977 and placed him in charge of training, operations, quality control, and equipment.

As the trial court correctly realized: "It does not take a McDonald's-trained French-speaking operational man to know that grease dripping from the vents must be stopped and not merely collected in a cup hung from the ceiling, that dogs are not permitted to defecate where food is stored, that insecticide is not blended with chicken breading; that past-dated products should be discarded; that a potato peeler should be somewhat cleaner than a tire-vulcanizer; and that shortening should not look like crank case oil."

Clearly, Maycock satisfied Dayan's request for a French-speaking operations man to run his training program . . . The finding that Dayan refused

non-French-speaking operational assistance and that McDonald's fulfilled Dayan's limited request for a French-speaking operational employee is well supported by the record. To suggest, as plaintiff does, that an opposite conclusion is clearly evident is totally without merit. Accordingly, we find McDonald's fulfilled its contractual obligation to provide requested operational assistance to Dayan.

In view of the foregoing reasons, the judgment of the trial court denying plaintiff's request for a permanent injunction and finding that McDonald's properly terminated the franchise agreement is affirmed.

Decision. Judgment was affirmed for McDonald's. McDonald's had fulfilled all of its responsibility under the agreement to assist the plaintiff in complying with the provisions of the license. The plaintiff had violated the provisions of the agreement by not complying with the QSC standards. The plaintiff was permitted to continue operation of his restaurants, but without use of the McDonald's trademarks or name.

Comment. Today most international franchise agreements call for dispute resolution through arbitration.

Case Questions

1. What social or cultural factors might have affected McDonald's presence in Paris?
2. How could McDonald's have exercised greater control over its foreign franchisee?
3. What types of products or services are most suitable for foreign licensing?

Foreign Direct Investment

In this text, the term **foreign direct investment (FDI)** refers to the ownership and operation or effective control of the productive assets of an ongoing business by an individual or corporate investor who is a resident or national of another country. FDIs are "active investments," as distinguished from passive investments (such as the purchase of stock for dividends or appreciation). They are generally made for the long term and with the expectation of being involved in company management and producing a profit from operations. FDI may include investments in manufacturing, mining, farming, assembly operations, and other facilities of production, as well as in service industries.

Throughout this book, distinctions are made between the home and host countries of the firms involved. The **home country** refers to that country

under whose laws the investing corporation was created or is headquartered. For example, the United States is home to multinational corporations such as Ford, Exxon, and Coca-Cola, but the companies operate in **host countries** in every region of the world. Of the three forms of international business, FDI provides the firm with the greatest opportunity for market penetration, the most involvement, and perhaps the greatest risk of doing business abroad. Investment in a foreign plant is often a result of having had successful experiences in exporting or licensing and of the search for ways to overcome the disadvantages of those other entry methods. For example, by producing its product in a foreign country, instead of exporting, a firm can become more competitive in the host market. It can avoid quotas and tariffs on imported goods, avoid currency fluctuations on the traded goods, provide better service and spare parts, and more quickly adapt products to local tastes

and market trends. Manufacturing overseas can mean taking advantage of local natural resources, labor, and manufacturing economies of scale.

Forms of Investment. Firms entering a foreign market through direct investment can structure their business arrangements in many different ways. Their options and eventual course of action may depend on such factors as industry and market conditions, capitalization of the firm and financing, and legal considerations. Some of these options include the start-up of a new foreign subsidiary company, the formation of a joint venture with an existing foreign company, a merger with a foreign company, or the acquisition of a foreign company by stock purchase.

A **foreign branch** is a business presence by the investor in the host country. It might be a branch office or an entire network of operational facilities. The branch is a part of the home country entity, with operations in the host country. A **foreign subsidiary** is a “foreign” company organized under the laws of a foreign host country, but owned and controlled by the parent corporation in the home country. A parent company that controls a majority of the stock of a subsidiary can control management and financial decision making. A subsidiary can also be part of a joint venture with another investor. Several subsidiaries owned by one parent are called **affiliates**.

A **joint venture** is a cooperative business arrangement between two or more companies for profit. It may take the form of a partnership or corporation. Typically, each party contributes a different type of expertise and each contributes different amounts of capital, each bringing its own special resources to the venture. A joint venture is often used where the laws of a host country require some local ownership or require that the investing foreign firm has a local partner. **Local participation** means that a share of the business is owned by nationals of the host country. Developing countries have a history of having local participation requirements, although these have been reduced to attract more investment. A disadvantage of the joint venture is that a company may have to share its technology, expertise, and profits with another company, or give up control over local operations.

Multinational Corporations. **Multinational corporations**, or multinationals, are firms that have significant foreign direct investment assets or that derive a significant portion of their revenues from more than

one country. Typically a multinational is comprised of a parent company in the home country and foreign affiliates located in host countries. A multinational is usually not a single legal entity. It is a global enterprise that consists of any number of interrelated corporate entities, connected through complex chains of stock ownership. Some “multinationals” are not actually corporations, but can take other forms, and some are state-owned trading organizations. They are characterized by their abilities to derive and transfer capital resources worldwide, move management and technology across national borders, operate facilities of production, deliver services, and penetrate markets in more than one country—often on a global scale. They can be domiciled in both developed and developing countries. The term **transnational corporation** is often used in the United Nations system, reflecting that the corporation’s operations and interests “transcend” national boundaries.

One significant trend in business during the last half of the twentieth century has been the “globalization” of multinational corporations. At one time, multinational corporations were simply large domestic companies with foreign operations. Today, they are global companies. They typically make decisions and enter strategic alliances with each other without regard to national boundaries. They move factories, technology, and capital to those countries with the most hospitable laws, the lowest tax rates, the most qualified workforce, or abundant natural resources. They see market share and company performance in global and regional terms.

CONDUCTING BUSINESS IN DEVELOPING AND NEWLY INDUSTRIALIZED COUNTRIES

While our introduction to the forms of international business applies generally to firms doing business anywhere in the world, companies do face special problems in developing countries, newly industrialized countries, and in emerging market economies. In this section we’ll take a brief look at the legal and economic environment of doing business there.

It is often useful to group countries according to socioeconomic criteria, even though they may be otherwise very different and in different geographic regions. For example, the countries of Vietnam in Asia, Libya in North Africa, and Bolivia in South America each have



different cultures, religions, geography, and per capita income levels, and very different political and trade relationships with the United States and other Western countries. Yet they have many of the same traits as other developing countries. So too are the countries of India, Brazil, and Malaysia; they are vastly different in their locations, cultures, geographies, and even sizes. However, the socioeconomic data of these countries show that they have much in common with each other and with other newly industrialized countries. Grouping like this is helpful in discussion and aids in statistical analysis. However, there is no one universally accepted definition for the terms “developing” or “newly industrialized” because economists are grouping countries for different purposes, and because there are so many different indicators of socioeconomic development.

Developed Countries

The developed countries generally have a high per capita income, have a high standard of living, and are in the later stages of industrialization. They are characterized by advanced technology, modern production and management methods, and advanced research facilities. They have diversified economies not dependent on agriculture, oil, or mining alone. Although the oil-dependent countries of the Middle East are very wealthy with a high standard of living, for example, they are not considered developed countries. It can be said that many developed countries are entering a postindustrial economy, with declining manufacturing but a growing service sector. The best examples of developed countries are the United States and Canada, the Western European nations, Israel, Japan, Australia, and New Zealand. The countries of Eastern Europe, most of which were freed from communist domination at the end of the 1980s, are for the most part considered to be developed countries.

Developing Countries

Compared to developed countries, developing countries generally have a lower per capita income, a lower standard of living, higher foreign debt, more rapid population growth, and a history of greater state control over their economy. The “typical” developing country is impossible to describe. Some rely almost exclusively on petroleum exports as their source of income. Many have large agrarian populations, densely populated cities, and a plentiful supply of unskilled labor. Many support high-tech industries. Although some are rich in

natural resources, such as Brazil, others have depleted theirs. The protection of the environment often takes a back seat to industrialization and economic “progress,” and so pollution often chokes their air and water. Sanitation and water systems are often inadequate. In some areas, toxic waste dumps may threaten entire communities. Economic crimes such as smuggling, hijacking and ocean piracy, organized crime, government corruption, and illicit drug production are frequently major problems. Education levels are generally far below that of the developed countries. Poor communication and transportation systems make business difficult. Inadequate distribution systems make it costly to get goods to market. Floods and natural disasters, exacerbated by inappropriate agricultural, land management and industrial policies, have disrupted entire populations. Overpopulation, homelessness, malnutrition, and disease are still common in many areas. The epidemic of plague that struck India in 1994, for example, caused workers to flee industrial communities in fear and forced the closing of many factories. Despite this bleak picture, developing countries do present trade, franchising, and investment opportunities for U.S. companies.

A wide disparity in social and economic classes exists in many developing countries, with great inequality in income and education between the rich and poor. Also, political systems differ widely in developing countries. Some have stable, democratic governments; others do not. For instance, Costa Rica has the oldest continuing democracy in Central America, dating back to 1948. Other less-stable Central and South American countries experience varying degrees of political and economic freedom, from parliamentary rule to military dictatorship.

Trade and Investment Policies in Developing Countries. Firms that do business in developing countries can face a host of adverse government policies, including high tariffs, taxes, import licensing requirements, financial regulation, controls on technology transfer, and trade and investment barriers that protect local industries from competition. Consider these examples: Governments in developing countries might allow the import of goods and services needed for their own socioeconomic development plans, such as tractors, machine tools, or power plants. However, they might ban or discourage the import of goods and services considered nonessential, or those that are available from local producers. They may allow investment in a chemical or pharmaceutical plant, but not one



making consumer goods for local sale. They may allow a foreign firm to produce there, but only if it does so in a joint venture with a local partner, to whom it must disclose or license its latest technology patents.

Another problem in doing business in developing countries is that the rules affecting international business often lack transparency; government regulations are often not published or made easily available to foreign firms. This makes regulations feel more like “red tape,” and compliance almost impossible. In addition, in many developing countries, bribery and corruption make it difficult to deal with local officials, even though such practices may be illegal and violators are prosecuted.

Each year the Office of the U.S. Trade Representative issues the *National Trade Estimate Report on Foreign Trade Barriers*, which reports on foreign barriers to trade and investment. The 2012 report on India illustrates some of the restrictions developing countries place on foreign business. Retailing, especially larger “multibrand” stores, is largely closed to foreign companies. Many products may not be imported without a license, creating long delays and uncertainty, with many licenses simply being denied. Private package delivery services are regulated to protect the government-owned postal service. Foreign investment is prohibited or restricted in agriculture, railways, and real estate. Although it has become easier to invest in the banking, telecommunications, and insurance sectors in recent years, these areas are still not widely open to foreign firms. Government procurement contracts for goods

and services rarely go to foreign firms, but are usually granted to Indian state-owned firms. Entrance to the accounting and legal professions is highly restricted.

Many of the hostile policies in developing countries, dating back to the first half of the last century, were based on socialist agricultural and economic policies that led to central planning and the government ownership of some farms, businesses, and industries. Some developing countries that had been subject to colonialization by European countries continued their resentment even long after gaining independence, and later directed it at the power and influence of Western multinational corporations. Some argued that multinationals were only present in their countries to exploit their natural resources and cheap labor, and to circumvent laws by bribing local officials. They felt that multinationals should be controlled for the good of society. Needless to say, these attitudes did not help attract foreign investment.

Today most developing countries recognize that foreign firms bring capital, technology, innovation, jobs, and tax revenues. In recent decades, most developing countries have slowly loosened controls over trade and investment. As the developing countries joined the World Trade Organization they became committed to opening their markets to foreign goods and services, and to removing barriers to investment.

The following case, *In re Union Carbide Corporation Gas Plant Disaster at Bhopal*, involves a U.S. multinational company that faced problems in owning and operating a plant in India.



In re Union Carbide Corporation Gas Plant Disaster at Bhopal

809 F.2d 195 (1987) United States Court of Appeals (2d Cir.)

BACKGROUND AND FACTS

Union Carbide Corporation (UCC) had been one of the largest chemical and industrial companies in the world, operating in dozens of countries. UCC's subsidiary in India, UCIL, had grown to fourteen plants, employing more than 9,000 Indian citizens, manufacturing a variety of products, including chemicals, plastics, batteries, fertilizers, and pesticides. UCIL was incorporated under the laws of India. Fifty-one percent of UCIL stock was owned by UCC, 24 percent by the government of India, and the balance by approximately 23,500 Indian citizens. The stock was publicly traded in India. In the 1970s, India issued a license to UCIL to produce

pesticides at a plant to be built in Bhopal. UCC provided the basic design for the plant, but India insisted that its own engineering firms and contractors build it. From 1972–1980, the construction was supervised by Indian engineers and many changes were made to the design. Labor and employment policies were set by the Indian government and the construction was managed and operated entirely by Indian citizens. The operations of the plant were regulated by more than two dozen Indian governmental agencies; however, enforcement of environmental, health, and safety standards by regulators was weak and ineffective. Maintenance procedures and record keeping at the plant were inadequate. In 1984,

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poisonous methyl isocyanate gas was released from the plant and blew into densely occupied parts of the city of Bhopal, resulting in the deaths of several thousand Indian citizens (estimates range from 2,000–10,000) and severe injuries to several hundred thousand others.

In April 1985, the Indian government filed a complaint in the federal courts in New York on behalf of the victims. UCC contended that the action should properly be heard in the courts of India. The district court agreed and dismissed the action.

MANSFIELD, CIRCUIT JUDGE

The vital parts of the Bhopal plant, including its storage tank, monitoring instrumentation, and vent gas scrubber, were manufactured by Indians in India. Although some 40 UCIL employees were given some safety training at UCC's plant in West Virginia, they represented a small fraction of the Bhopal plant's employees. The vast majority of plant employees were selected and trained by UCIL in Bhopal. The manual for start-up of the Bhopal plant was prepared by Indians employed by UCIL.

In short, the plant has been constructed and managed by Indians in India. No Americans were employed at the plant at the time of the accident. In the five years from 1980 to 1984, although more than 1,000 Indians were employed at the plant, only one American was employed there and he left in 1982. No Americans visited the plant for more than one year prior to the accident, and during the five-year period before the accident the communications between the plant and the United States were almost nonexistent.

The vast majority of material witnesses and documentary proof bearing on causation of and liability for the accident is located in India, not the United States, and would be more accessible to an Indian court than to a U.S. court. The records are almost entirely in Hindi or other Indian languages, understandable to an Indian court without translation. The witnesses for the most part do not speak English but Indian languages understood by an Indian court but not by an American court. These witnesses could be required to appear in an Indian court but not in a court of the United States. * * * The accident and all relevant events occurred in India. The victims, over 200,000 in number, are citizens of India and located there. The witnesses are almost entirely Indian citizens. The Union of India has a greater interest than does the United States in facilitating the trial and adjudication of the victims' claims.

India's interest is increased by the fact that it has for years treated UCIL as an Indian national, subjecting it to intensive regulations and governmental supervision of the construction, development, and operation of the Bhopal plant, its emissions, water and air pollution, and safety precautions. Numerous Indian government officials have regularly conducted on-site inspections of the plant and approved its machinery and equipment, including its facilities for storage of the lethal methyl

isocyanate gas that escaped and caused the disaster giving rise to the claims. Thus India has considered the plant to be an Indian one and the disaster to be an Indian problem. It therefore has a deep interest in ensuring compliance with its safety standards. Moreover, plaintiffs have conceded that in view of India's strong interest and its greater contacts with the plant, its operations, its employees, and the victims of the accident, the law of India, as the place where the tort occurred, will undoubtedly govern.

Decision. The district court's dismissal of the actions against UCC was upheld. The doctrine of *forum non conveniens* is a rule of law, stating that to further the administration of justice, where a case is properly heard in the courts of more than one country, it should be heard in the country with the greater interest in the outcome of the case, and where it is most convenient. In this case that is India.

Comment. In 1989, the Supreme Court of India approved a settlement fund of \$470 million to compensate the victims of the disaster. The company has long maintained that the tragedy resulted from employee sabotage at the plant.

Case Questions

1. India gained its independence from Great Britain in 1947. Like many developing countries with agrarian economies, independent India embarked on a long period of socialist and protectionist policies. How do you think this affected the investment climate in India? How do you think this defined the relationship between UCC and the Indian government prior to 1984?
2. Why do you think UCC might have chosen to produce agricultural pesticides in India rather than export those products to India from plants in developed countries?
3. Why did India require local management and control? What are the advantages and disadvantages of local management, and what problem does it present to the multinational?
4. Had the legal requirements in India concerning the handling of hazardous chemicals been less than those required in the United States, should UCC have ethically followed the higher U.S. standard?
5. Do you think that a parent corporation, like UCC in this case, should be financially liable for torts committed by its foreign subsidiary? Should the parent be protected by the limited liability of its corporate veil, or should a multinational firm with a "global purpose" be responsible under some theory of "single-enterprise" liability? How would this affect the attitude toward investment worldwide?

The Newly Industrialized Countries

The **newly industrialized countries** are developing countries that have made rapid progress toward becoming industrialized or technology-based economies. They are located in all regions of the world, including Latin America, the Middle East, and Southern and Southeast Asia. Much of their successes in recent years are due to highly motivated workforces and stable climates for foreign investment. Typically they are transitioning from agricultural economies to industrial ones, with burgeoning urban populations in the manufacturing centers. Their manufacturing is export oriented, producing a broad mix of high-quality products from computers to steel. Indeed, many newly industrialized countries are home to multinational corporations that operate in foreign countries. They are magnets for foreign investment and have reserves of foreign exchange. Their successes have led to dramatic rises in per capita gross domestic product and to improvements in jobs, wages, education, health care, living accommodations, and overall quality of life. Newly industrialized countries have also benefited from many social and political reforms that have led to democracy and fundamental freedoms. In Asia, the countries of Indonesia, Malaysia, the Philippines, Thailand, China, and India are considered newly industrialized. Other countries outside of Asia that may be described as transitioning to newly industrialized status are Mexico, Brazil, Turkey, and South Africa.

Although they are now widely considered to have highly developed economies, the best-known newly industrialized economies are the four “Asian Tigers”: Hong Kong, Singapore, Taiwan, and South Korea.

Emerging Market Economies. The term **emerging market economy** is often used to describe countries or regions with the potential for rapid economic growth. Many of them are transitioning from heavily state-controlled economies to market economies. The term can apply to countries or regions that are considered newly industrialized, developing, or even developed. There is no precise definition, and the term is most frequently used in the investment field when referring to countries viewed as having growth opportunities for foreign investors. The largest emerging markets include China, India, Brazil, and Russia, but could also include smaller countries such as Saudi Arabia, Thailand, and Mexico. The term **countries in transition** refers to those countries that are transitioning from centrally planned economies (usually based on communist doctrine) to

free markets. These include the countries of the former Soviet Union and its former Eastern European allies, China, and a few others.

The Least-Developed Countries

The **least-developed countries (LDCs)** are those defined by the United Nations on the basis of several socioeconomic criteria. Examples are low per capita income, poor nutrition and health, high adult literacy, unstable agricultural production, weak export economy, and large populations displaced by natural disasters. Examples of least-developed regions or countries are most of sub-Saharan Africa, such as Rwanda and Somalia, Haiti in the Caribbean, Bangladesh and Cambodia in Asia, and Afghanistan in Central Asia. They lack many of the basic resources needed for development and require vast amounts of foreign aid from the wealthier nations. Many of these countries have inadequate roads and bridges, inadequate public utilities and telephone systems, poor educational and health-care facilities, lack of plentiful drinking water, unstable governments, little or no technological base, high infant mortality, AIDS and other diseases, rampant crime, ethnic and tribal warfare, public corruption, and weak or nonexistent financial institutions. According to the United Nations, most of the population is under the age of 25. Business opportunities for trade in consumer goods and for the products and services of most Western companies are limited. Least-developed countries are in need of investments and products that will help them deal with these basic problems.

SOME COMMON RISKS OF INTERNATIONAL BUSINESS

International business differs from business at home for many obvious reasons. Distance, culture, language, currency, and government control are a few examples. As you will see in this section, they can present new challenges and risks to international managers.

Distance and Logistics

Managing many international transactions means managing the risks of shipping goods, getting paid, and doing business over great distances. In an import/export transaction, the risk that the buyer will fail or refuse to pay is called **payment or credit risk**. This



may mean finding special ways of assuring payment for goods being shipped to far-off countries, including the use of international banking services. For many exporters it means attending international trade shows and visiting their customers to get to know them personally.

Similarly, importers and purchasing managers for international firms learn to manage **supplier risk**, such as the possibility of being victims of fraud or receiving defective goods. Most experienced managers visit their suppliers, tour their plants, and work as partners. Purchasers also frequently use foreign agents to inspect cargo before shipment to make sure it complies with the contract. Purchasers come to quickly appreciate the words of one experienced purchasing manager: "There is no substitute for personally knowing your supplier."

Distance also means that parties must consider **property or marine risk** to cargo. Goods can be damaged by salt water or air, ships wreck, planes crash,

refrigeration breaks down, food spoils, "sealed" ocean containers are pilfered, grain becomes infested, and so on. As between buyer and seller, who bears the risk of loss to goods at sea or in the air? And when is and is not the carrier responsible? Exporters also learn how to arrange transportation and manage their shipping costs. With rates often based on the greater of weight or volume, they learn to creatively compress and package for shipment. For instance, items can be vacuum packed to remove air, liquids can be dehydrated to remove water, and both can be added back in the country of destination. After all, why pay to ship air or water?

All international firms are subject to the risks of war, terrorism, or international hostilities. This includes the risks to international shipping. The following case, *Transatlantic Financing v. United States*, is one of many cases resulting from the closing of the Suez Canal during a war in the Middle East.



Transatlantic Financing Corporation v. United States

363 F.2d 312 (1966) United States Court of Appeals (D.C. Cir.)

BACKGROUND AND FACTS

The United States contracted with Transatlantic Financing, the operator of a cargo ship, to transport wheat from Texas to Iran in 1956. The parties never agreed on the route the ship would take. Six days after the ship left Texas, the government of Egypt was at war with Israel and blockaded the Suez Canal. As a result, the ship had to sail around the Cape of Good Hope on the southern tip of Africa, extending the voyage several thousand miles and adding an additional 14 percent to Transatlantic's costs. Transatlantic sued for the added expense, claiming that it had agreed only to travel the "usual and customary" route to Iran through Suez, and that its performance became legally impossible. The lower court ruled in favor of the United States, and Transatlantic appealed.

J. SKELLY WRIGHT, CIRCUIT JUDGE

* * * It is now recognized that "A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost." [citations omitted].* * *

It seems reasonable, where no route is mentioned in a contract, to assume the parties expected performance by the usual and customary route at the time of contract. Since the usual and customary route from Texas to Iran at the time of contract was through Suez, closure of the Canal made impossible the expected method of performance. But this unexpected

development raises rather than resolves the impossibility issue, which turns additionally on whether the risk of the contingency's occurrence [closure of the canal] had been allocated and, if not, whether performance by alternative routes was rendered impracticable.

The contract in this case does not expressly condition performance upon availability of the Suez route. Nor does it specify "via Suez" or, on the other hand, "via Suez or Cape of Good Hope." Nor are there provisions in the contract from which we may properly imply that the continued availability of Suez was a condition of performance. Nor is there anything in custom or trade usage, or in the surrounding circumstances generally, which would support our constructing a condition of performance. The numerous cases requiring performance around the Cape when Suez was closed, *see e.g., Ocean Tramp Tankers Corp. v. V/O Sovfracht (The Eugenia)*, (1964) 2 Q.B. 226 . . . indicate that the Cape route is generally regarded as an alternative means of performance. [Thus, the risk of canal closure was not allocated by contract or custom to either party.]* * *

We turn then to the question whether occurrence of the contingency rendered performance commercially impracticable under the circumstances of this case. The goods shipped were not subject to harm from the longer, less temperate Southern route. The vessel and crew were fit to proceed around the Cape. Transatlantic was no less able than the United States to purchase insurance to cover the contingency's occurrence. If anything,

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it is more reasonable to expect owner-operators of vessels to insure against the hazards of war. They are in the best position to calculate the cost of performance by alternative routes (and therefore to estimate the amount of insurance required), and are undoubtedly sensitive to international troubles which uniquely affect the demand for and cost of their services. The only factor operating here in Transatlantic's favor is the added expense, allegedly \$43,972.00 above and beyond the contract price of \$305,842.92, of extending a 10,000-mile voyage by approximately 3,000 miles. While it may be an overstatement to say that increased cost and difficulty of performance never constitute impracticability, to justify relief there must be more of a variation between expected cost and the cost of performing by an available alternative than is present in this case—where the promisor can legitimately be presumed to have accepted some degree of abnormal risk and where impracticability is urged on the basis of added expense alone.

Decision. Judgment affirmed for the United States. The closure of the canal and the resulting additional

expenses of the alternate route did not make the contract commercially impracticable, (and therefore not legally impossible) to perform.

Case Questions

1. Did the parties agree on what would happen if the Suez Canal had closed? In other words, did they allocate the risk of closure? Would that have changed the result?
2. What is Transatlantic's argument? If admiralty law implies that a ship's journey will be by the "usual and customary" route, why did the court not hold that the contract had become impossible to perform? How does the court define "impossible"?
3. Did Transatlantic's performance become *impracticable*? How difficult was it for Transatlantic to take the alternate route around Africa?
4. Suppose it had been bad weather instead of a blocked canal? Would the case outcome have been different? How about a tsunami? What if a government order had prohibited the ship from departing Texas?

Language and Cultural Differences

International business people know the importance of language and culture in every business relationship, and the ability to speak a foreign language is certainly an advantage. But the international business world is filled with successful people who are not fluent in a foreign language. They adapt by learning some basic courtesies in the language of a country they are visiting, and being especially sensitive to social conventions, cultural issues, and religious beliefs. There is some truth in the saying that if you're the buyer, the seller will find a way to speak your language; but if you're the seller, you must find a way to communicate with your customer. One corporate CEO argued that he could not possibly know

all the languages of all the countries in which he does business. While true, that argument may not be so valid for an international sales manager who does business in one or two primary foreign markets. Some positions require an even greater level of foreign language competency. As a firm moves toward greater penetration of a foreign market, for instance, when negotiating a licensing or investment contract, it will become crucial to use native speakers or nationals of the host country. Contracts will often be written in the languages of both parties, and so the use of foreign lawyers may also be necessary. The case of *Gaskin v. Stumm Handel* illustrates what can happen when a party is not able to read and understand a foreign language contract.



Gaskin v. Stumm Handel GMBH

390 F. Supp. 361 (1975) United States District Court (S.D.N.Y.)

BACKGROUND AND FACTS

The plaintiff, a U.S. citizen, entered into an employment contract with the German firm of Stumm Handel, the defendant. The contract was written entirely in German. Without being able to speak or read German, the plaintiff signed the contract. He never received an English language version. However the terms of the contract

were explained to him in English. One of the terms of the contract, known as a "forum selection clause," provided that any disputes that might arise between the parties would be settled in the courts of Germany. Later, when the parties reached a disagreement, the plaintiff brought this action against the defendant in the United

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States, contending that his failure to understand German rendered the forum selection clause invalid.

CANELLA, DISTRICT JUDGE

With regard to such translation, Gaskin asserts that “I was never informed that by executing the (contract), I was consenting to the Republic of West Germany (now Germany) as the forum within which I must submit all controversies” and that “had I known this, I would not have agreed to the same, as such an obligation is onerous and unconscionable, and a deterrent to bringing any actions whatsoever.” . . . We find that in making the foregoing assertions, Gaskin flies in the face of well-settled contract law principles and has failed to sustain his burden.

It is a settled proposition of contract law in this state and nation that “the signer of a deed or other instrument, expressive of a *jurai* act, is conclusively bound thereby. That his mind never gave assent to the terms expressed is not material. If the signer could read the instrument, not to have read it was gross negligence; if he could not read it, not to procure it to be read was equally negligent; in either case the writing binds him (citations omitted). . . .”

While Mr. Gaskin’s apparent “blissful ignorance” with regard to the contract under which he was to render his labors to the defendant strikes us as highly incredible as a matter of common sense, we take note of certain facts which are relevant to the disposition of this matter. It must be remembered that Mr. Gaskin is not an ignorant consumer, unlearned in the language of the contract, who has become entangled in the web of a contract of adhesion through the overreaching or other unconscionable practices of the defendant. The contract at bar does not involve the credit sale of a refrigerator or color television set, but rather compensation of some \$36,000 per annum for Mr. Gaskin’s services

as the manager in charge of the defendant’s New York operations which were to be conducted under the name Stumm Trading Company. His office (Park Avenue, New York City) is not located in an area which would have precluded his easy access to a competent translation of the involved document. There existed no emergency condition or other exceptional circumstances at the time plaintiff entered into this contract; conditions which might now serve to excuse his present plight. Mr. Gaskin has advanced no evidence to support a finding that the contract sued upon is other than one which was fairly negotiated at arm’s length and in a businesslike fashion between the parties and voluntarily entered into by him in the hope of reaping a great economic benefit. . . .

Thus, we find that the instant transaction was a commercial arrangement of a nature which warranted the exercise of care by Mr. Gaskin before his entry into it and that his conduct with regard to this undertaking can only be characterized as negligent, the consequences of which he must now bear. . . .

Decision. The court dismissed the plaintiff’s action, holding that the plaintiff’s failure to speak or read German was not grounds for invalidating any of the provisions of the contract.

Case Questions

1. Why did Gaskin claim that he was not bound by the forum selection clause included in the contract to which he agreed?
2. In business, is a party to contract negotiations obligated to provide translation services to other parties?
3. If the parties to a contract execute two copies of a contract, one in each language, which is the operable and effective document?

Cross-Border Trade Controls

Whenever goods, services, money, or people cross an international border, they are regulated by government. The movement of goods is governed by the laws and regulations of the countries through which they pass. The most common regulations are controls on exports, tariffs, and nontariff barriers to trade.

Export Controls and Sanctions. An **export control** is a restriction on exports of goods, services, or technology to a country or group of countries imposed for reasons of national security or foreign policy. All countries have export controls. Those in the United States are enforced through an export licensing system administered by the Bureau of Industry and Security

of the U.S. Department of Commerce. Export licensing requirements can apply to exports of almost any type of goods or technology, although advanced technology items that can contribute to the military capability of a foreign nation are most strictly regulated. **Sanctions** are broader and more comprehensive restrictions on trade and financial transactions with countries, who sponsor international terrorism, engage in the proliferation of weapons of mass destruction, threaten international peace, or violate major principles of international law. They can include restrictions on travel to those countries and are often based on resolutions of the United Nations Security Council. In the United States, they are primarily administered by the Department of Treasury.



Tariff and Nontariff Barriers. The most common import barriers are tariffs and nontariff barriers. A **tariff** is an import duty or tax imposed on goods entering the custom's territory of a nation. Most tariff rates today are determined by trade negotiations between nations and are no longer the great barrier to trade that they were at one time. U.S. Customs and Border Protection of the Department of Homeland Security enforce tariff laws in the United States.

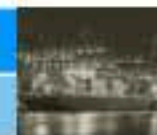
Nontariff barriers are all barriers to the import of foreign goods or services other than tariffs. They usually are laws or administrative regulations that have the effect, directly or indirectly, of restricting access of foreign goods or services to a domestic market. A **quota** is a quantitative restriction on imports that limits the quantity of an item that may enter a country annually. International trade laws today prohibit countries from using quotas to keep out foreign goods, except in very limited circumstances. Examples of indirect nontariff barriers are health and safety regulations, environmental regulations, and industrial and agricultural standards.

Currency Risk

A firm is exposed to currency risk whenever it transacts business in a foreign currency or makes an investment in a host country whose currency is different from that of the home country. Examples are pricing and selling goods for export in a currency other than your own

or operating a business in a foreign country where the profits are derived in that country's currency. Currency risk includes (1) exchange rate risk and (2) currency control risk. Currency risk exists when a firm must convert one currency to the currency of another country before it can be used.

Exchange Rate Risk. **Exchange rate risk** results from the fluctuations in the relative value of two currencies when one is exchanged for the other. In a simple export/import transaction, the party dealing in the foreign currency bears the exchange rate risk. If the contract calls for payment in the seller's currency at some future date, the buyer bears the exchange rate risk in the intervening period. By quoting prices in its own currency, the seller has shifted the exchange rate risk to the buyer. Of course, if the seller quoted prices in a buyer's currency, the seller would be assuming the exchange rate risk. The ability of a firm to manage its currency risk depends on the firm's size, sophistication, and global resources. Multinational corporations also have other, more complex and sophisticated options for managing exchange rate risk. For instance, a multinational corporation's subsidiary in a foreign country may have excess local currency derived from revenues there. These assets can be transferred to affiliated units owned by the parent company for use anywhere in the world. In the following case, *Bernina Distributors v. Bernina Sewing Machine Co.*, the parties failed to consider the impact of currency fluctuations on their contract.



Bernina Distributors v. Bernina Sewing Machine Co.

646 F.2d 434 (1981) United States Court of Appeals (10th Cir.)

BACKGROUND AND FACTS

The defendant purchased sewing machines from a Swiss manufacturer in Swiss francs. The machines were imported into the United States for sale to distributors. The contract with the distributor in this case allowed the importer to pass on cost increases to the distributor. When the Swiss franc rose "precipitously" in value against the dollar, the importer imposed a 10 percent surcharge to protect itself. Eventually the increased value of the Swiss franc doubled the importer's costs. The distributor did not feel that this additional "cost" fell under the terms in the contract and sued to have the contract enforced at its original price. The importer argued that increased costs due to currency fluctuations could be passed on to the distributor as any

other "cost." It also argued that the exchange risk had rendered performance of the contract commercially impracticable. Just prior to the contract the dollar had fallen 7 percent on the franc. The district court interpreted the contract terms to find for the distributor, and the importer appealed.

LOGAN, CIRCUIT JUDGE

* * * [The contract] limits all price increases incurred by reason of invoice, duty, insurance, freight, handling, broker, port fees, and "other similar charges" to the extent of the increases. Thus, we believe the contract places the risk of a diminishing profit margin on Importer in case of increasing costs and find the trial court's holding that the Importer bears the risk of

continues



continued

currency fluctuations, once a price is established for a model, is amply supported by the record. * * *

Importer asserts that the court's interpretation makes the contract impracticable under *Utah Code Ann. s 70A-2-615 (1980)*. [The contract stated that it was to be governed by Utah law]. That U.C.C. section excuses performance under the contract "(e)xcept so far as a seller may have assumed a greater obligation" when performance "has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made." In our view the instant contract is not one made "impracticable" by the contingency of the devalued dollar. The contract, as interpreted by the trial court, always allows a gross profit margin, although the return on capital investment has been reduced considerably because of the devaluation of the dollar. Moreover, there is considerable evidence that Importer assumed this particular risk. The contract lumps all the shipping and invoice costs in one provision which allows price increases only to the extent of the cost increases to Importer. Importer's letter to Distributor concerning a 7 percent devaluation of the dollar in relation to the franc, sent three weeks prior to the contract execution, shows clear foreknowledge of the possibility of currency fluctuations and, thus, supports the finding that section 2-615 is inapplicable. [citations omitted]

Finally, cost increases alone, though great in extent, do not render a contract impracticable. In *Gulf Oil Corp. v. F. P. C.*, 563 F.2d 588, 600 (3d Cir. 1977), the Third Circuit held that the doctrine of impracticability was not available unless the party seeking to excuse performance could show he could perform only at a loss, and that the loss would be especially severe and unreasonable. We hold the defense of impracticability is unavailable in the instant case. * * *

Decision. Judgment affirmed for the distributor. The importer had assumed the exchange rate risk. The language of the contract did not include currency fluctuations as one of the cost increases that could be passed on to the distributor, thus the exchange rate risk remained with the importer. Cost increases and currency fluctuations alone do not render a contract too "impracticable" to perform.

Case Questions

1. What were the importer's two arguments in this case? How did the court address each?
2. What is the effect of the fact that just prior to executing the contract, the dollar had fallen by 7 percent against the Swiss franc?
3. In any international business transaction, which party assumes the exchange rate risk?

Currency Controls. **Currency controls** are restrictions on foreign currency transactions used by some developing countries that do not have large reserves of foreign currency. Controls can take many forms, such as prohibiting residents from making payments in a foreign currency; prohibiting any foreign payments unless on government approval or through authorized bank accounts; prohibiting the removal of foreign currency from the country by individuals traveling abroad; prohibiting the exchange of foreign currency for local currency at other than the official rate of exchange; and controls on foreign investors, prohibiting them from removing or **repatriating profits** earned by their subsidiary companies within the country. To preserve foreign currency, some governments in developing countries have prohibited the import of luxury or consumer goods or other products that the government deems nonessential. Currency controls can be enforced with criminal penalties. Most countries, such as Russia and

India, have loosened or eliminated currency controls in recent years due to the requirements of the International Monetary Fund and the World Trade Organization.

Political Risk. **Political risk** is generally defined as the risk to a firm's business interests resulting from political instability or civil unrest, political change, war, or terrorism in a country in which the firm is doing business. It can also include unexpected government regulations that are hostile to foreign interests. Political risk is sometimes unpredictable, and is greatest in countries undergoing rapid economic or political change, such as in developing countries. Even though foreign business interests may have been welcomed by one government, its successor may take a different view. For many years, a nation may welcome foreign investment, consumer products, and Western culture, and then virtually overnight turn to resent any foreign influence at all. Cuba and Iran

are two key examples. For much of U.S. history, U.S. firms had friendly relationships and extensive investments there. Yet after political upheaval, these countries became hostile to Americans and American investment. Exhibit 1.2, *Ranking of the Most Important Constraints to FDI in Developing Countries*, and Exhibit 1.3, *Types of Political Risk of Most Concern to Investors in Developing Economies*, illustrate that political risk is one of the biggest concerns for corporate investors in developing countries. At the time of this publishing, these were based on the most recent reports from World Bank's Multilateral Investment Guarantee Agency or MIGA.

Political Risk: Loss of the Investor's Property. The transfer of private-sector firms to government ownership and control, usually with payment to shareholders and pursuant to a larger plan to restructure a national economy, is known as **nationalization**. In

developing countries, political reasons or socialist-inspired economics are often the motivation behind nationalization. A recent example is Venezuela's nationalization of its oil and gas industries by its socialist government, which asserted legal ownership over all oil and gas deposits and control over distribution. But nationalization also occurs in Western nations, including the United Kingdom, Canada, and even the United States, for reasons such as to save a dying but needed industry. For example, in 1971 the United Kingdom purchased Rolls Royce, the critical British maker of aircraft engines. Rolls Royce was returned to private ownership in 1987. There are many other policy reasons for nationalizing an industry. After the terrorist attacks in the United States in 2001, for example, the air transportation security industry was taken out of private hands, nationalized, and put under the Department of Homeland Security.

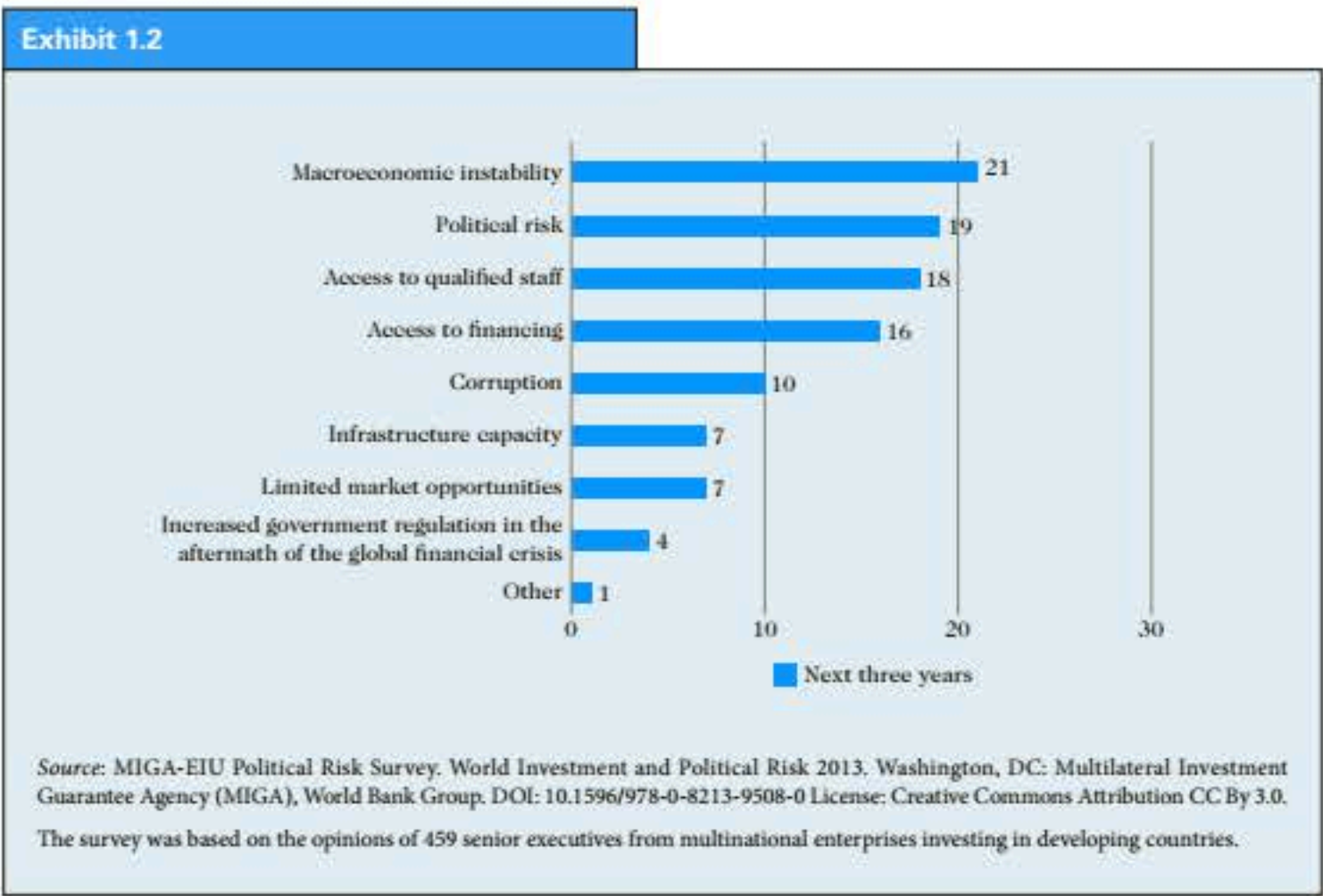
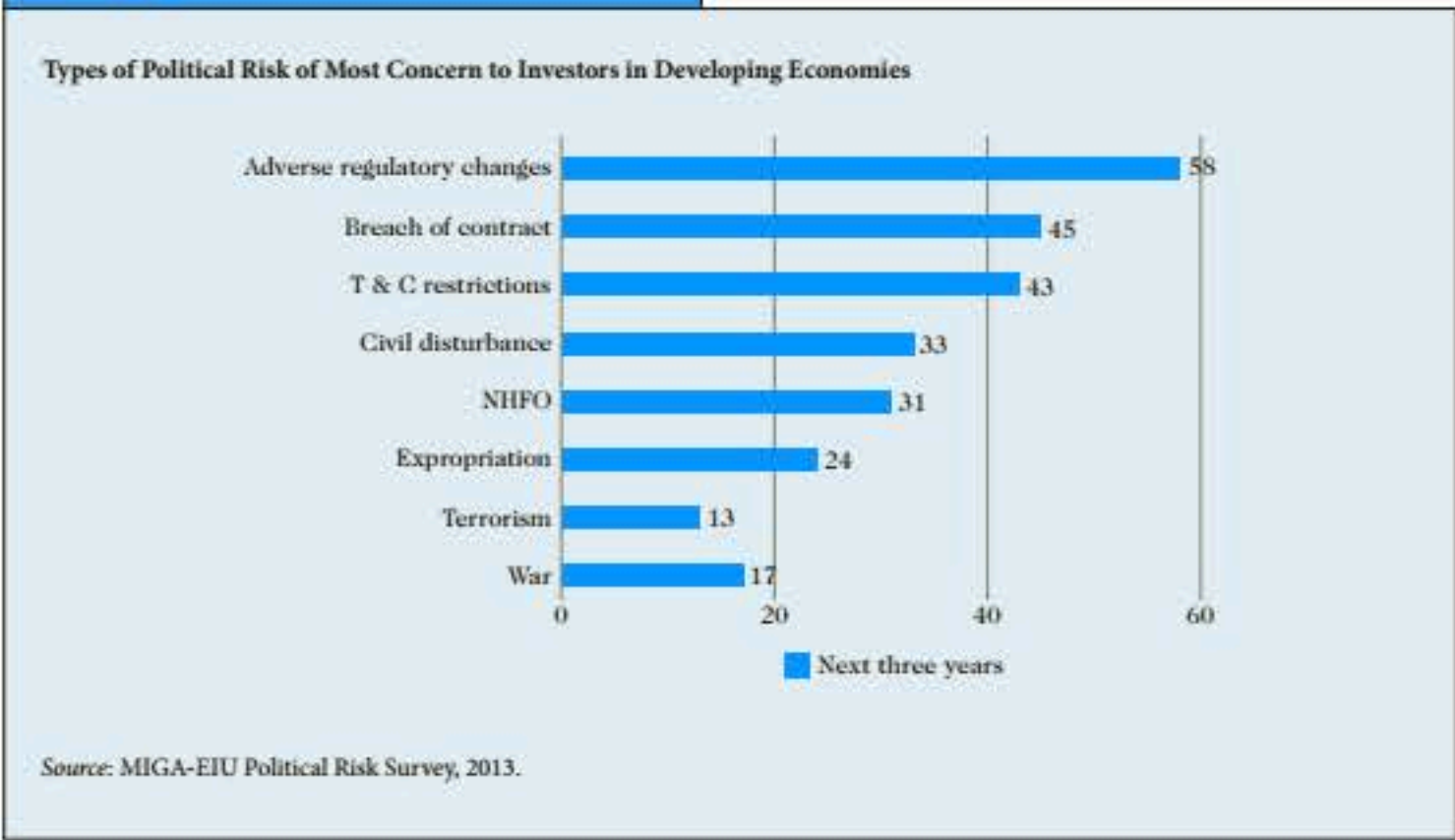


Exhibit 1.3



Expropriation is the taking of privately owned assets, such as real estate, factories, farms, mines, or oil refineries, by a government with the payment of some compensation. Although the compensation is supposed to be “just,” in some countries it often is not. **Confiscation** is expropriation without payment of any compensation.

Political Risk Analysis. International managers know to keep abreast of political risk wherever their operations and interests could be affected. Firms can obtain political risk analysis reports (as well as broader country risk reports) from many sources, including country risk consulting and ratings firms, insurance industry reports, reports of U.S. government agencies, and informal discussions with experienced international bankers and shipping company representatives. Two published resources are the U.S. Central Intelligence Agency *World Fact Book* and the U.S. Department of Commerce *Country Commercial Guides*. In some cases, political risk insurance is available to firms making investments in foreign countries where their

exposure is great. A firm engaged in strategic corporate planning should consider this information when developing its global business strategy and when transacting business.

Exposure to Foreign Laws. We are all responsible for complying with the laws of every country in which we do business. Foreign criminal laws apply to each of us as individuals and to corporate entities. Many acts that are perfectly legal in one country can be illegal in another. Moreover, in some countries, local laws may not be readily understandable to the average foreign guest, and the costs of not complying can be great. The same can be true for business laws. The greater the firm’s penetration into the foreign market, the greater its risk. Thus foreign investors have great liability for failing to comply with local laws and regulations.

Many people are at first surprised at the laws they encounter in foreign countries. After all, many laws have social and cultural underpinnings. For example, Americans would never think about the need to apply

for a government license before opening a grocery store. In the United States, “mom-and-pop” retail stores, as well as large-scale discount stores, open and close every day. But in many countries, including European countries with a long history of powerful trade unions, shopkeeper unions, and apprenticeships, the

attitudes are very different. The following case, *DIP SpA v. Comune di Bassano del Grappa*, considered the legality of an Italian law requiring retailers to obtain permission from a local committee before opening a new store. American students should consider just how “foreign” this concept really is.



DIP SpA v. Comune di Bassano del Grappa

Case 140-142/94 Joined, [1995] ECR I-03257
Court of Justice of the European Communities (2nd Chamber)

BACKGROUND AND FACTS

Italian law prohibits the opening of certain retail stores without first obtaining a license from the local authorities. A request for a license might be denied if it was believed that the market is adequately served already. The license could be granted by the local mayor on the advice of a 10 to 15-person local committee made up of local government representatives, local merchants, and members of local unions of shopkeepers and workers. This particular action was brought by three applicants whose licenses to open new retail stores in Italy had been denied. One of the applicants, a subsidiary of a German company, argued that the Italian retail licensing law discriminated against non-Italian companies and imported goods, and lead to higher consumer prices. It argued that the Italian law was invalid under the laws of the European Union and the Treaty of Rome.

HIRSCH P.C., PRESIDING

During the oral hearing the applicants submitted that, because the Act operated effectively to exclude new entrants, many of whom would be non-Italian operators desirous of establishing large-scale and sometimes discount outlets which might sell more non-Italian goods than existing traders, it was likely, either actually or at least potentially, to hinder intra-Community trade.

I believe that this argument must be rejected. [W]hile the limits the Act overall number of trading licenses, it does not necessarily produce an overall decrease in the number or value of goods sold on the Italian market nor does it necessarily render more difficult the sale of imports as opposed to domestic goods. I accept the Commission’s observation that this type of provision is not capable of hindering intra-Community trade. . .

The Italian Act provides that licenses are to be issued by the mayor of the municipality concerned, taking into account the criteria laid down in the municipal

commercial development plan. The purpose of that plan is to provide the best possible service for consumers and the best possible balance between permanent trading establishments and foreseeable demand from the population.

National rules which require a license to be obtained before a new shop can be opened and limit the number of shops in the municipality in order to achieve a balance between supply and demand cannot be considered to put individual traders in dominant positions or all the traders established in a municipality in a collective dominant position, a salient feature of which would be that traders did not compete against one another.

On this point, it is sufficient to observe that rules such as those contained in the Italian Act make no distinction according to the origin of the goods distributed by the businesses concerned, that their purpose is not to regulate trade in goods with other Member States and that the restrictive effects which they might have on the free movement of goods are too uncertain and indirect for the obligation which they impose to be regarded as being capable of hindering trade between Member States.

Decision. The Italian law requiring the licensing of new retail stores by local committees is not invalid under the laws of the European Union and the Treaty of Rome.

Comment. Consider the dual effect of this law. It not only barred entry to multinational retailers from outside of Italy, but also to the large volume of imported products they would be likely to sell.

It was soon evident that supermarkets and mass retailers would change the face of Italy. Since this decision, the number of supermarkets in Italy has almost doubled, and traditional family-owned businesses, with all the character, richness, and history they represent, has sadly declined. But even a country like Italy, where for generations shoppers made daily stops at the meat,

continues



continued

produce, or dairy store, they seemed to enjoy the new convenience and lower prices.

Case Questions

1. What was the ostensible purpose of the Italian law? What was its effect?

2. Do you think this law creates a climate ripe for corruption?
3. Why was the law not found to be discriminatory?
4. Assume that a municipality in a foreign country passes a law limiting the size of retail stores in the city. How might this affect U.S. firms wanting to open stores there?

Country Risk: Exposure to Foreign Courts. Settling disputes between companies can be much more difficult in international business than in domestic business. Litigating a case in a court in a foreign country is both costly and time consuming. A firm may need representation by attorneys in its own country *and* in the country of litigation. Frequent court appearances could require great travel expense. International cases also involve complex procedural problems: Which country's courts should hear the case? Which country's laws should apply? How does a court compel the testimony of witnesses or the production of business records not found in that country? Should the case be submitted to arbitration—perhaps in some “neutral” country? When a firm is negotiating an agreement with a foreign party, such as a contract to sell goods or to franchise a business, both parties will usually want to reach an agreement on these issues, and so the advice of an attorney at this stage in a transaction is extremely important.

Obtaining Professional Assistance

International managers must often rely on professional advice from attorneys, bankers, freight forwarders and customs brokers, insurance carriers and agents, government trade specialists, and others.

Attorneys who practice in international business can be either in private practice or employed as in-house counsel to larger or multinational firms. Their work might include export law, customs and tariff law, immigration and nationality law, the licensing of intellectual property, foreign investment contracts, international antitrust law, admiralty or maritime law, drafting and negotiating international contracts, and other legal issues. Private practice attorneys who specialize in these areas are usually located in larger cities and have associations with other lawyers in foreign countries. Attorneys who are employees of multinational corporations regularly

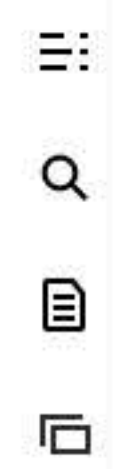
advise management, develop internal corporate policies, work on external government relations at home and abroad, take responsibility for international tax matters, supervise litigation abroad, and coordinate the work of foreign counsel.

Freight forwarders and **customs brokers** act as the agent for the exporter or importer in arranging transportation and insurance for goods, preparing import or export documents, and moving goods through customs. A power of attorney is required when acting as customs broker for the importer. Many forwarding and brokerage companies operate with offices in several major port cities. Customs brokerage firms in the United States are licensed and bonded under the rules of the Federal Maritime Commission and the U.S. Bureau of Customs and Border Protection.

The international divisions of major banks not only provide important financing but also offer a range of specialized international banking and foreign exchange services necessary to international firms. Many international bankers possess a great wealth of expertise and foreign contacts and can play an advisory role in international business.

CONCLUSION

One primary objective of this chapter was to set the stage for the remainder of the book by surveying the legal environment of international business. Another broader objective is to illustrate how international business differs from domestic business, especially in developing countries, and how those differences affect the risks of an international business transaction. As your education progresses, you should see how the study of international business law can help you plan strategies and enter transactions with a greater awareness of these risks and if necessary how to communicate with your attorney on these issues.



Chapter Summary

1. The three forms of international business, or methods of entering a foreign market, are trade, the licensing of intellectual property, and foreign direct investment.

2. Trade consists of importing and exporting, including trade in goods and services.

3. Successful exporters make a long-term commitment to their foreign markets and customers and undertake an export plan. Success also requires building interpersonal relationships with foreign business associates and fostering an attitude of trust.

4. Cross-border trade in services includes business services such as passenger fares, shipping, package delivery, banking, insurance, securities brokerage, accounting, management and engineering consulting, and other professional services.

5. Importing should not be viewed as an isolated, one-time transaction. Most successful importers have a “global sourcing” strategy.

6. Intellectual property rights can be transferred through a licensing agreement in return for a royalty or other compensation arrangement. IPRs can be rendered worthless if they are not protected and infringement occurs.

7. Foreign direct investment refers to the long-term ownership and operation or active control of an ongoing business in a foreign “host” country with the expectation of producing a profit.
8. Multinational corporations are firms with significant foreign direct investment assets. They are increasingly “globalized,” meaning that they have the ability to derive and transfer capital resources worldwide and to operate facilities of production and penetrate markets in more than one country, usually on a global scale.

9. While the developing countries attract hundreds of billions of dollars in investments each year, the economic and political climate in many developing countries still presents many obstacles to trade and investment.

10. International business differs from domestic business because of distance, currency, language, culture, national controls over trade and investment, country risk, and differences in national laws and legal systems.

11. In international business, there is no substitute for knowing your suppliers, customers, and partners, visiting their facilities, and building relationships based on trust.

12. An important lesson of this chapter is that the management of international business is the management of risk. By understanding the legal environment of international business we are better prepared to evaluate, manage, and reduce these risks.

Key Terms

trade 3	export plan 6	affiliates 11
exporting 3	intellectual property (IP) 6	joint venture 11
importing 3	intellectual property rights (IPRs) 6	local participation 11
trade in services 3	license 7	multinational or transnational corporation 11
direct exporting 3	licensing agreements 7	newly industrialized countries 15
foreign sales representatives 3	infringement 8	emerging market economy 15
foreign distributors 3	transfer of technology 9	countries in transition 15
international trading company 3	franchising 9	least developed countries (LDCs) 15
indirect exporting 3	foreign direct investment (FDI) 10	payment or credit risk 15
export trading companies 4	home country 10	supplier risk 16
Export Trade Certificate of Review	host countries 10	property or marine risk 16
certificate of origin 4	foreign branch 11	export controls 18
export management companies 5	foreign subsidiary 11	



sanctions 18	currency controls 20	confiscation 22
tariff 19	repatriating profits 20	freight forwarders 24
non tariff barriers 19	political risk 20	customs brokers 24
quota 19	nationalization 21	
exchange rate risk 19	expropriation 22	

Questions and Case Problems

1. Two cases in this chapter, *Transatlantic Financing* and *Bernina Distributors*, involved very different facts but similar issues of law. What legal issues do they have in common? In each case there is some unexpected “super-vening event” that interfered with one party’s ability to perform and with their expectations in the contract. In either case, did the nonperforming party have a legally recognized “excuse for nonperformance”? Why or why not? While you might have to wait until a later chapter for a full answer, how do you think parties to a contract might deal with these uncertainties in advance?
2. How does international business differ from domestic business? Explain how those differences affect the risk of doing business internationally. What factors influence that risk?
3. International business managers try to build trust with their foreign counterparts, whether it is a customer, supplier, or partner. How would you suggest they do this? Why is trust important to the long-term relationship, and what might it mean to managing the risks of international business?
4. Pro Golf, a U.S. company, manufactured and sold golf equipment under the brand name “First Flight,” which had been registered in the United States and certain other foreign countries. Pro Golf negotiated with Wynn to act as its foreign sales representative in Japan. Wynn incorporated First Flight Associates, Inc. (FFA) under Japanese law for the purposes of selling Pro Golf’s products there. The parties then entered into an informal trademark agreement, evidenced only by a letter from Pro Golf’s president to FFA, permitting FFA to use Pro Golf’s “First Flight” trademark on “soft goods” such as golf bags and clothing, in return for a royalty. There were no restric-tions on sublicensing. FFA attempted to sublicense the trademark to another Japanese company, Teito, for a roy-alty much larger than that paid to Pro Golf. When Pro Golf objected, the company learned that its attempt to register the trademark in Japan had not been completely successful, but that third parties had obtained the right to use the “First Flight” trademark in Japan in marketing soft goods. Pro Golf terminated the agency agreement with Wynn and FFA, and FFA brought this action for breach of contract. What is the result? Do you agree with Pro Golf’s strategy for entering the Japanese market? What advice would you have given Pro Golf on entering the Japanese market? *First Flight Associates v. Professional Golf Co., Inc.* 527 F.2d 931 (6th Cir. 1975).
5. Plaintiff, a Swiss corporation, entered into contracts to purchase chicken from B.N.S. International Sales Corpora-tion. Defendant was a New York corporation. The English language contracts called for the delivery of “chicken” of various weights. When the birds were shipped to Switzer-land, the 2 lb. sizes were not young broiling chickens as the plaintiff had expected, but mature stewing chickens or fowl. The plaintiff protested, claiming that in German the term *chicken* referred to young broiling chickens. The question for the court was: What kind of chicken did the plaintiff order? Was it “broiling chicken,” as the plaintiff argued, or any chickens weighing 2 lbs., as the defendant argued? *Fri-galment Importing Co., Ltd. v. B.N.S. International Sales Corp.*, 190 F. Supp. 116 (S.D.N.Y. 1960). What could the par-ties have done to avoid this misunderstanding?
6. Successful international managers agree that success in entering a foreign market comes from planning and com-mitment. What does this mean? What kind of commit-ment do you think they are referring to? It is also often said that exporting is not an “elixir” for a company that is failing in its home market and is looking for new sales elsewhere. Evaluate this statement. Do you think it is true?
7. What industries in your state are the leading exporters? Who are the leading export firms? What do you think is the impact of exports on your state’s economy? Where would you go for information? What role does your state government play in promoting exports?
8. U.S. firms have been successful in foreign franchising, particularly in fast-food and other retail businesses and service companies. How do you account for this success? Where do you think the best opportunities and hottest markets are for foreign franchising?
9. There are many U.S. government programs to aid Amer-ican firms in boosting exports. The International Trade Administration and its U.S. Commercial Service, as well as the Small Business Administration administer several of these programs. Undertake an Internet search of gov-ernment resources for small and medium-sized exporters. What services does the U.S. Commercial Service offer? What trade statistics are available? Country information? Foreign market information? Export counseling? Match-making and trade contact programs?



Managerial Implications

Your company, Quiet-Maid, manufactures home washers and dryers in the United States that use a patented technology to make them run virtually silent. Having been successful in the United States, Quiet-Maid's CEO wants your opinion on exporting to the European market.

1. What are the advantages of Quiet-Maid exporting appliances to Europe from the United States?
2. What problems do you foresee with exporting large appliances there? What barriers and/or problems do you think the company might face?
3. What factors might influence success in Europe?

The CEO now decides that the best course of action is to enter the European market by forming a joint venture with a Spanish manufacturer of home appliances. Quiet-Maid would contribute its quiet technology and financial and technical assistance in return for a 40 percent share. The Spanish company would oversee manufacturing, sales, and service and receive a 60 percent share.

1. Why did Quiet-Maid choose a joint venture as its vehicle to enter Europe? In addition to manufacturing, sales, and

service, what else might the local Spanish firm do for the joint venture?

2. What reasons do you think Quiet-Maid had for not starting a new subsidiary in Europe on its own?

During negotiations, Quiet-Maid's management went to Spain to review its prospective partner's finances. During their visit, they were asked "which set of books and numbers" they wanted to review—the real financial records of the Spanish company or those used to report to Spanish tax authorities. Quiet-Maid became uneasy about their potential exposure as a minority partner in a foreign investment with this company, and decided to withdraw.

1. What did Quiet-Maid discover on its trip to Spain?
2. What are the risks of making an investment in this foreign joint venture?
3. If Quiet-Maid decides that there is no other possible joint venture partner available in Europe, and if it does not have the resources to start a new subsidiary, what is its alternative? What other significant assets does Quiet-Maid have that it could leverage to still do business with the Spanish firm? Explain.

Ethical Considerations

All of us understand that the law is a floor for judging our behavior, an absolute minimum standard of conduct that one must follow. Anyone doing business in a foreign country understands that he or she must abide by the laws of the host country. But what about the unwritten or informal rules of doing business there—rules based on culture, religious codes, and societal constraints? Sometimes these laws can be very different from those in one's home country or in other countries in which one is working. Pollution may be a crime in one country and tolerated in another; bribery may be a crime in one country and customary in another. What is an accepted practice for employing children in industry in one country may be abhorrent in another, and so on. How does the multinational manager reconcile differences like these? What is the appropriate standard of ethical conduct for a multinational manager—that of his or her home country, the host country, or of some internal personal value system? How will the laws, unwritten rules, and cultural values of the host country influence the manager? How does one balance his or her social responsibility regarding the health, safety, and well-being of the people of the host country with the company's overall objective of maximizing shareholder profit? What can a multinational corporation do to aid its managers in the

development of a personal value system that is in keeping with the legal and cultural values of their host countries? Consider some of the legal and ethical issues in the following problems.

1. You have been negotiating with a representative of a government in Africa to sell products for a new state building project in his country. The negotiations are finalized during your trip to his offices in Africa. After easily negotiating a fixed price and delivery, he "suggests" that you prepare a price quotation on a "pro forma invoice"—at double the negotiated price. His government will pay the full amount shown on the invoice through a foreign bank, and your firm will pay him the difference as a "commission" in U.S. dollars deposited to his personal bank account in New York. He convincingly argues that this practice is customary in his country. The temptation for you is great; the deal would be a profitable one. Should you make the payment? Does it matter that it is customary in his country? Do you think it is lawful under American law? Does it matter that this is taking place in Africa, far from the United States? Is there a "victim" in this case?
2. Your company intends to locate a plant in Mexico to manufacture tires for sale in both Mexico and the



United States. If the plant were in the United States, the laws would require expensive safeguards to protect the health and safety of U.S. workers, as well as the added cost of minimum wage rules, Social Security contributions, health insurance, retirement benefits, and other employee benefits. Assume that Mexican law is not so strict, that wages and operating costs are less, and that benefit programs are either nonexistent or far less costly. To what extent should you conform to the legal standards applicable in the United States? Should you comply with American labor rules and environmental rules, even though they are not enforceable in Mexico? After all, should not all workers be safe from harm? Does not polluted air in Mexico travel to the United States? Do you think that any firm operating in a host country should carry with it the ethical codes of its home country? What about competition from firms in Japan or Germany that are operating their plants in Mexico? If they don't comply with American labor and environmental standards in Mexico, how will you compete with them? How does the international manager justify decisions in cross-cultural situations?

3. You are an international manager for a U.S. apparel designer that sells to major U.S. department stores and retailers. Several years ago, your firm decided to have clothing sewn in India and Pakistan, which resulted in tremendous cost savings over having the work done in the United States. In making the decision, the firm considered its impact on U.S. families who depend on the income from these jobs. It opted for the cost savings, seeing its responsibility to produce a profit for shareholders as more important than its responsibility to provide jobs in the United States. Now, however, it finds that its contractor in India is overworking and abusing child labor in violation of internationally accepted standards for the treatment of children in the workplace. The Indian government shows little interest in policing its own labor practices. The sad story of the Indian children runs on national television and appears in the national press. What course of action should you take? If you decide to discontinue working with sewing contractors in India, do you do so to protect Indian children, because of the adverse publicity in the United States, or for both reasons? What do you expect the reaction would be from shareholders? From consumers?

4. While your answer to this question may have to wait until the next chapter, do you think that a written corporate code would aid a manager in resolving these conflicts and in making difficult choices? How would a corporation draft such a code, and what sources would it draw on?



CHAPTER 2

International Law and the World's Legal Systems



INTRODUCTION

This chapter examines the law of treaties, customary international law, principles of international jurisdiction, and the role of international organizations in fostering international laws and ideals. We will look not only at the historical development of international law, but how it addresses a range of current issues, particularly international business, commerce, and transnational crimes. Because much international law stems from international norms, we will also briefly look at developing norms for the social responsibility of multinational corporations. Finally, we will take a comparative look at three of the major legal systems in place around the world today, including the common law, civil law, and Islamic legal systems.

INTERNATIONAL LAW

The exact origins of international law, and whether it dates to antiquity or to the Middle Ages, is debatable. The ancient Greeks, Chinese, and Romans all recognized some rudimentary concepts of international law. However, the term *international law* is thought to be derived from the Latin term *jus gentium*, meaning “the law of nations.” That term was used in reference to that part of ancient **Roman law** that governed public and private relations with foreigners and with the rulers of foreign lands.

Many legal historians believe that it was the rise of the European nation-state, first ruled by monarchs and later by sovereign governments, that led to the development of modern international law. In the sixteenth and seventeenth centuries, legal scholars from Spain, Italy, and Holland developed the first modern European concepts of international law. In 1625, Hugo Grotius, a diplomat and lawyer for the

Dutch East India Company, wrote *On the Law of War and Peace*, which brought together various schools of thought on the nature of law and international obligations. It was a time of colonialism, trade, and the rise of nations. Grotius wrote that the law of nations was not just divinely given, as was commonly believed in his day, but also that law arose by common agreement, by consensus, and by the accepted practice of nations. He premised these ideas on the idea of national sovereignty and on the recognition that all states are equal. To this day, it is accepted that international law arises not from the work of some supranational legislature, but because nations have agreed to follow customary and accepted rules or norms and to comply with treaties and conventions on which they agree.

Definition and Characteristics of International Law

International law is the body of rules applicable to the conduct of nations in their relationships with other nations, and with individuals and other private parties, rules for settling disputes between nations, as well as rules for intergovernmental organizations. It can also include crimes and criminal procedures applicable to genocide, war crimes, and offenses against humanity committed by individuals in an official capacity.

International law has several characteristics that distinguish it from a country's national or domestic law. First, instead of being dictated by a legislative body, international law consists of rules that countries agree to follow. It is lawmaking by choice and by consent. Indeed, international law exists because nations agree that it is in their best interests to cooperate and to conform to commonly accepted norms. Second, despite some commonly misunderstood beliefs about the United Nations and other international bodies, there is no global authority for enforcing international law. It is true that international courts and tribunals do issue judgments against nations. However, nations must



agree to be a party to these cases. The judgments are “binding” only according the authority of the court or tribunal under international law, and “hard” enforcement mechanisms of the kind used in national law do not really exist. There are courts, but no international sheriffs or marshals. Enforcement of international law relies on remedies that countries have agreed to in advance, or on economic or political sanctions. International law relies greatly on “soft” enforcement mechanisms such as the force of public opinion, diplomacy, or the withholding of foreign aid or other assistance. Of course, the ultimate sanction against a country for violating international law is war, or at least the threat of it. But the use of force is also limited by international law. Later we will see that domestic and international courts do add to the enforcement capabilities of international law.

Public and Private International Law. There are many ways of classifying types of international law. Two broad categories are public international law and private international law. **Public international law** refers to those rules that apply to the conduct of nations in their relationships with each other and with individuals as citizens or residents. For example, this might include rules for resolving territorial or boundary disputes, for conducting diplomacy or war, and for determining nationality, and also for how nations treat foreign citizens. It also includes the rules governing the status and operation of intergovernmental organizations, such as the United Nations or the International Court of Justice (ICJ).

Private international law refers to those rules that govern the rights and responsibilities of individuals, corporations, or other private parties in their cross-border or international activities, as well as procedural rules for how courts resolve private international disputes. For example, private international law might include family law and rules for international adoptions, wills and decedents’ estates who own property in more than one nation, and rules for international business transactions, such as sales contracts, international shipping, or the liability of commercial airlines to injured passengers.

Sources of International Law. The most frequently cited authority for the sources of international law is the *Statute of the International Court of Justice*, the judicial arm of the United Nations. It sets out both primary and secondary sources of international law. According

to Article 38, the primary sources of international law are (1) international treaties and conventions, (2) international custom, as evidence of a general practice accepted as law, and (3) the general principles of law recognized by civilized nations. Secondary sources provide evidence of what international law might be or how it should be interpreted. These include the decisions of international courts and tribunals, and to a lesser extent, the scholarly writings of respected jurists and legal scholars. For example, in the United States, the *Restatement of Foreign Relations Law*, published by the American Law Institute, is considered a secondary source of customary law. Resolutions of the UN General Assembly are also a nonbinding secondary source. Like scholarly writings, UN resolutions are of persuasive value only.

We begin our study with treaties.

The Law of Treaties

Sovereign governments have been entering into military and trade alliances with one another for thousands of years. While treaties have always played an important role in international life, today they have taken on a new meaning. As the world becomes “smaller” and more interdependent, new issues take on global proportions requiring global solutions. Scientific and technological advances are proceeding more rapidly than ever before. Air and water pollution know no national boundaries. Illegal drug trafficking, terrorism, computer crime, and other crimes have taken on transnational dimensions. The problems we all face have one thing in common: Resolving each of them requires cooperation and agreement. Treaties are the most important form of international agreement and a primary source of international law.

A **treaty** is a legally binding agreement between two or more nations that is recognized and given effect under international law. A treaty between two countries is said to be **bilateral**, and a treaty between three or more countries is **multilateral**. One of the most important principles of treaty law is *pacta sunt servanda* (“the pact must be respected”), meaning that treaties are binding on the parties by consent and must be performed by them in good faith.

A **convention** is a legally binding multilateral treaty on matters of common concern, usually negotiated on a regional or global basis and open to adoption by many nations. Many conventions are negotiated under the auspices of the United Nations, the European Union, or the Council of Europe.

Other Treaty Terminology. An agreement that modifies or adds to a treaty or convention, or that deals with matters less significant than those dealt within treaties, is known as a **protocol**. It usually addresses matters that are ancillary to a main treaty or convention. Nations adopt a treaty or convention when it is completed in its final form and is ready for nations to ratify. Nations that express their willingness to join a treaty are called **signatories**. **Ratification** is the formal agreement of a signatory nation to be bound by the treaty, usually by its own legislative approval. Countries that have ratified become **contracting parties**. A treaty becomes effective on the date set out in the treaty for it to “enter into force,” which is usually after some minimum number of nations become parties. A **reservation** is an exception to a treaty set out by a signatory country at the time of ratification. **Abrogation** is an act of a national legislature that renders a treaty null and void in that nation.

A word of caution when referring to treaties by name: Many people abbreviate the names of treaties by referring to the name of the city in which the treaties were completed. Examples of common names are “the Vienna Convention,” and “the Montreal Convention.” Many treaties discussed in this book were completed in Madrid, Vienna, Geneva, Budapest, Kyoto, Montreal, Paris, Warsaw, and other cities. Some cities have been the site of many treaties. For example, a reference to the “the Vienna Convention” can either mean the *Vienna Convention on Diplomatic Relations* or the *Vienna Convention on Protection of the Ozone Layer*—a big difference. Be careful when abbreviating treaty names.

The Legal Status and Domestic Law Effect of Treaties. To understand the legal effect of a treaty in a country that is a party to it, we must ask whether that treaty is self-executing or nonself-executing. A **self-executing treaty** (known in Europe as a treaty with “direct effect”) is one that automatically creates rights that are enforceable in the courts of that country, without any further legislative action. The treaty is immediately binding on courts, government agencies, and individuals. An example of a self-executing treaty enforceable by courts in the United States is the *Montreal Convention for the Unification of Certain Rules for International Carriage by Air* that sets out the rights of airlines and airline passengers for personal injuries or damage to baggage or cargo on international flights.

A **nonself-executing treaty**, or one without direct effect, is one that requires some additional legislative act before it becomes enforceable in national courts.

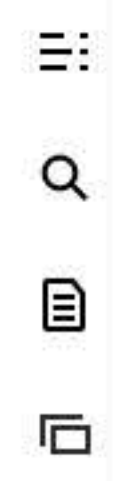
In some countries, most notably the United Kingdom, Canada, and Australia, few if any treaties have direct effect. Treaties there require parliamentary action before they are enforceable by private parties. In a few other countries, such as the Netherlands and France, treaties are given greater legal effect. The status of treaties may be found in the written constitution of a country (if that country is one with a written constitution), in a legislative act, or by judicial interpretation. The legal status of treaties in the United States has been the subject of many federal appellate court decisions. Whether a treaty is self-executing or not depends on the wording and history of the treaty itself and the intent of Congress.

In *Medellin v. Texas*, 552 U.S. 491 (2008), the U.S. Supreme Court held that judgments of the International Court of Justice (ICJ) were not enforceable by U.S. courts because the *UN Charter*, which created the ICJ, was nonself-executing. The case involved Jose Medellin, an 18-year-old Mexican national who had been arrested in the United States for murder. While in prison the International Court of Justice, sitting in The Hague, Netherlands, issued a judgment that Medellin (and 50 other Mexicans in U.S. prisons) had been deprived of rights under international law because Medellin had never been told that he had the right to notify the Mexican embassy of his arrest. The Court stated,

Article 94(1) [of the UN Charter] provides that “[e]ach Member of the United Nations undertakes to comply with the decision of the [ICJ] in any case to which it is a party.” The Executive Branch contends that the phrase “undertakes to comply” is not “an acknowledgement that an ICJ decision will have immediate legal effect in the courts of U.N. members,” but rather “a commitment on the part of U.N. Members to take future action through their political branches to comply with an ICJ decision.”

We agree with this construction of Article 94. The Article is not a directive to domestic courts. It does not provide that the United States “shall” or “must” comply with an ICJ decision, nor indicate that the Senate that ratified the *U.N. Charter* intended to vest ICJ decisions with immediate legal effect in domestic courts. . . . In other words, the *U.N. Charter* reads like “a compact between independent nations” that “depends for the enforcement of its provisions on the interest and the honor of the governments which are parties to it.”

Treaties of Friendship, Commerce, and Navigation (FCN). FCN treaties are bilateral agreements that provide a broad range of protection to foreign nationals doing business in a host country. Most countries are



party to many FCN treaties. In the United States, FCN treaties are self-executing. Although each treaty is different, they typically state that each country will allow the establishment of foreign branches or subsidiaries, the movement of capital and technology, the right of travel, and the right to own real estate. FCN treaties also assure the payment of just compensation for property

taken by government action and the nondiscriminatory treatment of personnel.

The following case, *Ventress v. Japan Airlines*, involves an FCN treaty between the United States and Japan in a case for wrongful termination of employment. It illustrates the relationship between treaties and legislation, and that treaty interpretation is a matter for domestic courts.



Ventress v. Japan Airlines
486 F.3d 1111 (2007) United States Court of Appeals (9th Cir.)

BACKGROUND AND FACTS

Japan Airlines (JAL) is a Japanese air carrier based in Tokyo, with offices in California and Hawaii. The plaintiffs were employed by a Hawaiian company that contracted to perform services for JAL flights. They alleged that JAL had required a seriously ill pilot to fly, in violation of aviation laws. After expressing their concerns to a JAL official and to aviation regulators, they claimed they experienced harassment from superiors, including required psychiatric evaluations, unsatisfactory evaluations, and termination. They sued in federal court seeking recovery for violation of California's whistle-blower protection statute and wrongful termination. The court dismissed the claims on the basis that the state statute had been preempted by the 1953 *Treaty of Friendship, Commerce, and Navigation* (FCN) between the United States and Japan. The plaintiffs appealed.

GOODWIN, CIRCUIT JUDGE

* * * A treaty preempts inconsistent state law. *United States v. Pink*, 315 U.S. 203 (1942). [other citations omitted] Federal law must also be strictly construed to avoid conflict with treaty obligations. The district court premised its judgment on article VIII(1) of the *Japan FCN Treaty*, which provides:

Nationals and companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice . . . [emphasis added by court].

* * * "The purpose of the Treaties was not to give foreign corporations greater rights than domestic companies, but instead to assure them the right to conduct business on an equal basis without suffering discrimination based on their alienage." *Sumitomo Shoji Am., Inc. v. Avagliano*, 457 U.S. 176 (1982) ("Sumitomo II"). "The Treaties accomplished their purpose by granting foreign corporations 'national treatment' in most respects." *Id.* at 188. National treatment entitles a foreign national to "carry on his chosen business under conditions of non-discrimination, and to enjoy the same

legal opportunity to succeed and prosper on his merits as is allowed citizens of the country." *MacNamara v. Korean Air Lines*, 863 F.2d 1135, 1143 (3d Cir. 1988). * * *

Given the purpose and history of the FCN treaties, our sister circuits have consistently held that foreign employers do not enjoy immunity from domestic employment laws that do not interfere with the employers' ability to hire their fellow citizens. In *MacNamara*, the Third Circuit considered a provision in the *Korea FCN* treaty that is identical in language to article VIII(1). The [U.S.] plaintiff, having been terminated by his Korean employer and replaced by a Korean citizen, sought recovery for race, national origin and age discrimination. The employer argued that it enjoyed treaty conferred immunity from federal anti-discrimination statutes. The court disagreed. The court explained that the treaty's negotiating history "[w]as barren of any suggestion that Article VIII(1) was intended to achieve anything other than the right to utilize one's own citizens in the capacities specified." * * * Although the Korean employer had a treaty right to discriminate in favor of Korean citizens, the treaty afforded no immunity from liability for race, age and national origin discrimination. [emphasis added]

We hold that the district court erred by construing article VIII(1) to confer on Japanese employers blanket immunity from state employment law. * * * California's whistle-blower protection laws merely prevent JAL from retaliating against employees for reporting and resisting the employer's domestic law violations; the laws in no way conflict with JAL's limited treaty right to discriminate in favor of Japanese citizens. In the absence of conflict, there can be no preemption.

Decision. Judgment reversed for plaintiffs. Although the FCN treaty does allow Japanese companies in the United States to give preference to hiring Japanese citizens as executives, professional staff, and technical experts "of their choice," it does not give them blanket immunity from state and federal employment laws.

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Case Questions

1. What was the purpose of Article VIII(1) of the FCN treaty? In what way would this give JAL, or other foreign corporations, greater control of their U.S. operations?
2. What was the basis of the court's ruling? Does the California whistle-blower protection statute

"interfere with the employer's ability to hire their fellow citizens"?

3. In citing *MacNamara v. Korean Airlines*, the Court refers to the difference between "citizenship" and "national origin." What is the difference, and why was that important here?

The Vienna Convention on the Law of Treaties. The interpretation of treaties is governed by customary international law rules. The *Vienna Convention on the Law of Treaties*, which became effective in 1980 in about half of the countries of the world, codified many of the customary rules. It covers such issues as when treaties enter into force, how they are interpreted or amended, and the rights and duties of contracting parties. Although the treaty has not been ratified by the United States, many U.S. courts apply its provisions as customary law.

Customary International Law

Custom has always been at the root of legal development, and that includes international law. **Customary international law** is a body of commonly accepted rules of conduct, or **international norms**, that have arisen out of consistent and long-standing practice, and that nations have followed out of a sense of binding obligation. Historically, examples of customary international law include rules for prosecuting the crimes of slavery, piracy, or genocide, rules for diplomatic immunity and the protection of ambassadors, rules for the inviolability

of embassies, rules that protect civilians during war, or rules governing the seizure of private vessels during wartime. The legal effect of customary international law is different from country to country. Even within the common law countries of the United Kingdom, Canada, and Australia, there are differences. Some judges in the United Kingdom have held that customary norms are automatically a part of the common law. Other judges rely on customary norms for their persuasive value. On the other hand, in a landmark 1999 Australian case, the court held that crimes under customary law, like treaties, are not part of Australian domestic criminal law unless specifically enacted in legislation.

In recent years there has been increasing debate over whether customary international law is part of American law, and if so, which customs and norms are part of it and which are not. In the United States, however, it is generally accepted that customary international law is a part of American law to be applied by courts where there is no contradictory statute or treaty and where there is no other way to resolve the case other than by applying customary norms. The following well-known decision of the U.S. Supreme Court, *The Paquete Habana*, reflects this view.



The Paquete Habana

175 U.S. 677 (1900) United States Supreme Court

BACKGROUND AND FACTS

During the Spanish-American War, the United States Navy seized two commercial fishing ships sailing from Havana. The unarmed ships were owned by a Spanish citizen living in Cuba and sailed under Spanish flags. The owners were unaware of the hostilities between the United States and Spain and of the U.S. blockade of Cuba. The fishing ships were sold by the Navy in Florida as "prizes of war." Their original owner sued for damages in U.S. District Court. The court upheld the seizure and the owner appealed.

JUSTICE GRAY

By an ancient usage among civilized nations, beginning centuries ago, and gradually ripening into a rule of international law, coast fishing vessels, pursuing their vocation of catching and bringing in fresh fish, have been recognized as exempt, with their cargoes and crews, from capture as prize of war * * *

The doctrine which exempts coast fishermen, with their vessels and cargoes, from capture as prize of war, has been familiar to the United States from the time of the War of Independence * * *

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International law is part of our law, and must be ascertained and administered by the courts of justice of appropriate jurisdiction as often as questions of right depending upon it are duly presented for their determination. For this purpose, where there is no treaty and no controlling executive or legislative act or judicial decision, resort must be had to the customs and usages of civilized nations, and, as evidence of these, to the works of jurists and commentators who by years of labor, research, and experience have made themselves peculiarly well acquainted with the subjects of which they treat. Such works are resorted to by judicial tribunals, not for the speculations of their authors concerning what the law ought to be, but for trustworthy evidence of what the law really is * * *

This review of the precedents and authorities of the subject appears to us abundantly to demonstrate that at the present day, by the general consent of the civilized nations of the world, and independently of any express treaty or other public act, it is an established rule of international law, founded on consideration of humanity to a poor and industrious order of men, and

of the mutual convenience of belligerent states, that coast fishing vessels, with their implements and supplies, cargoes and crews, unarmed and honestly pursuing their peaceful calling of catching and bringing in fresh fish, are exempt from capture as prize of war * * *

This rule of international law is one which prize courts administering the law of nations are bound to take judicial notice of, and to give effect to, in the absence of any treaty or other public act of their own government in relation to the matter * * *

Decision. The Supreme Court reversed and said that under an established rule of international law peaceful fishing vessels are exempt from capture as prizes of war. The Court acknowledged that it was bound to take judicial notice of international law.

Case Questions

1. Under what conditions is customary international law a part of U.S. domestic law?
2. Which international norm or custom applies to this dispute?

Limits on International Customary Law: The U.S. Alien Tort Statute. The *U.S. Alien Tort Statute* (ATS) was enacted in 1789. It gave the U.S. federal courts jurisdiction over civil actions for damages brought by non-U.S. citizens for torts committed against them by other noncitizens outside of the United States in violation of the norms of customary international law. For almost 200 years the statute was seldom used. However, in the 1980s, a number of cases were brought under the statute to recover damages from U.S. companies accused of cooperating with foreign governments in abusing

human rights. Many executives of U.S. multinational corporations were concerned that they could be sued in the United States by noncitizens who were accusing them of supporting, or participating in, human rights violations such as unfair or abusive labor practices, environmental damage, or worse (such as aiding and abetting foreign government-sponsored torture and killings). In the following case, *Sosa v. Alvarez-Machain*, the court discussed the limitations on the incorporation of customary international law into U.S. law through the ATS.



Sosa v. Alvarez-Machain

542 U.S. 692 (2004) United States Supreme Court

BACKGROUND AND FACTS

Alvarez, a Mexican physician, was wanted by the U.S. Drug Enforcement Agency for the torture and murder of one of its agents in Mexico in 1985. When Mexico would not extradite Alvarez, the agency employed Sosa to kidnap Alvarez from his home and fly him by private plane to Texas, where he was arrested by federal officers. Alvarez was tried and acquitted in a U.S. court. After the acquittal, Alvarez brought this civil suit in U.S. District Court against Sosa for damages under

the U.S. Alien Tort Statute (ATS). The ATS reads: "The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." 28 U.S.C. §1350. Alvarez sued on the theory that the abduction and arrest were a tort committed in violation of customary international law. Alvarez won a judgment against Sosa in District Court, and it was upheld by the U.S. Court of Appeals. Sosa appealed to the U.S. Supreme Court.

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JUSTICE SOUTER

Alvarez says that the ATS was intended . . . as authority for the creation of a new cause of action for torts in violation of international law. We think that reading is implausible. As enacted in 1789, the ATS . . . bespoke a grant of jurisdiction, not power to mold substantive law. * * *

"When the United States declared their independence, they were bound to receive the law of nations, in its modern state of purity and refinement." *Ware v. Hylton*, 3 Dall. 199 (1796). [William Blackstone, in 4 *Commentaries on the Laws of England* 68 (1769)] . . . mentioned three specific offenses against the law of nations addressed by the criminal law of England: violation of safe conducts, infringement of the rights of ambassadors, and piracy. An assault against an ambassador, for example, impinged upon the sovereignty of the foreign nation and if not adequately redressed could rise to an issue of war. It was this narrow set of violations of the law of nations, admitting of a judicial remedy and at the same time threatening serious consequences in international affairs, that was probably on minds of the men who drafted the ATS with its reference to tort. * * *

The second inference to be drawn from the history is that Congress intended the ATS to furnish jurisdiction for a relatively modest set of actions alleging violations of the law of nations . . . As Blackstone had put it, "offences against this law [of nations] are principally incident to whole states or nations," and not individuals seeking relief in court. 4 *Commentaries* 68. * * *

[A]lthough the ATS is a jurisdictional statute creating no new causes of action, the reasonable inference from the historical materials is that the statute was intended to have practical effect the moment it became law. The jurisdictional grant is best read as having been enacted on the understanding that the common law would provide a cause of action for the modest number of international law violations with a potential for personal liability at the time.

We think it is correct, then, to assume that the First Congress understood that the district courts would recognize private causes of action for certain torts in violation of the law of nations, though we have found no basis to suspect Congress had any examples in mind beyond those torts corresponding to Blackstone's three primary offenses: violation of safe conducts, infringement of the rights of ambassadors, and piracy.

Accordingly, we think courts should require any claim based on the present-day law of nations to rest on a norm of international character accepted by the civilized world and defined with a specificity comparable to the features of the eighteenth-century paradigms we have recognized. This requirement is fatal to Alvarez's claim. * * * Since many attempts by federal courts to craft remedies for the violation of new norms

of international law would raise risks of adverse foreign policy consequences, they should be undertaken, if at all, with great caution. * * *

[Alvarez] attempts to show that prohibition of arbitrary arrest has attained the status of binding customary international law. * * * It is this position that Alvarez takes now: that his arrest was arbitrary and as such forbidden by international law not because it infringed the prerogatives of Mexico, but because no applicable law authorized it. * * * Alvarez cites little authority that a rule so broad has the status of a binding customary norm today. He certainly cites nothing to justify the federal courts in taking his broad rule as the predicate for a federal lawsuit, for its implications would be breathtaking. His rule would support a cause of action in federal court for any arrest, anywhere in the world, unauthorized by the law of the jurisdiction in which it took place, and would create a cause of action for any seizure of an alien in violation of the Fourth Amendment. * * *

Whatever may be said for the broad principle Alvarez advances, in the present, imperfect world, it expresses an aspiration that exceeds any binding customary rule having the specificity we require. It is enough to hold that a single illegal detention of less than a day, followed by the transfer of custody to lawful authorities and a prompt arraignment, violates no norm of customary international law so well defined as to support the creation of a federal remedy.

Decision. Judgment reversed for *Sosa*. Alvarez's arrest did not violate any norm of customary international law that would permit an action for damages under the *Alien Tort Statute*. Recovery under the ATS should be limited to well-defined violations of norms of international law that are accepted by the civilized world, "principally incident to whole states or nations, and not individuals seeking relief in court." The abduction and arrest in this case did not meet that standard.

Comment. In *Kiobel v. Royal Dutch Petroleum Co.*, 133 S.Ct. 1659 (2013), the Supreme Court held that, perhaps with the exception of piracy on the high seas, the First Congress in 1789 did not intend that the ATS would apply extraterritorially (outside the United States). In *Kiobel*, Nigerian nationals residing in the United States sued Dutch, British, and Nigerian oil companies under the ATS for allegedly aiding and abetting the Nigerian government in the torture and execution of Nigerian environmentalists who were protesting oil exploration in Nigeria. The Court referred to its warning in *Sosa* that lawsuits under the ATS should not be permitted where they would cause "unwarranted judicial interference in the conduct of foreign policy." The Court stated,

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"These concerns . . . are all the more pressing when the question is whether a cause of action under the ATS reaches conduct within the territory of another sovereign." 133 S.Ct. at 1664, 1665. The Court stated that although the ATS could be applied to violations of safe conduct and assaults on ambassadors within the United States, it could not be applied outside the United States. With regard to whether piracy on the high seas could be a violation of international customary law, the Court noted, "Pirates were fair game wherever found, by any nation, because they generally did not operate within any jurisdiction. We do not think that the existence of a cause of action against them is a sufficient basis for concluding that other causes of action under the ATS reach conduct that does occur within the territory of another sovereign; pirates may well be a category unto themselves." *Id.* at 1667.

Case Questions

1. What were the three specific offenses mentioned by Blackstone that were recognized as violations of customary international law at the time the ATS was enacted?
2. Is the Court willing to expand the ATS beyond these original three offenses? According to Justice Souter, what types of torts would give rise to jurisdiction under the ATS?
3. Do you feel that this decision grants too much or too little power to the federal courts to hear tort claims occurring outside the country?
4. What foreign policy implications are involved in a U.S. court hearing a case under the ATS?
5. In what way did the Supreme Court's subsequent decision in *Kiobel* further limit the application of customary international law?

INTERNATIONAL BUSINESS LAW AND CRIMES

In this book, **international business law (IBL)** is the body of law and regulations, derived from national and international sources, that governs cross-border business transactions, the activities of those doing business in foreign countries or subject to the jurisdiction of foreign courts, and the resolution of international disputes. IBL includes both public and private international law, and overlaps with "international economic law," a term used by some international lawyers. Several main subject areas of IBL that we introduced in Chapter 1 are international trade and transportation (import and exports), the international aspects of licensing and protecting intellectual property, foreign direct investment, and the operations of firms in foreign host countries.

Sources of International Business Law

IBL today is found in modern treaties, multilateral conventions, statutes, the acts of government departments and agencies, court decisions, and the decisions of international courts and tribunals. However, many basic concepts of modern IBL developed over centuries from the **law merchant** and maritime law—the accepted customs and practices of ancient and medieval merchants, traders, bankers, mariners, and ship owners. The practices were local at first, but spread rapidly as

people began sharing customs and learning that consistent rules were enhancing commerce. Soon private merchant courts and maritime courts in port cities were adopting these customs. Kings and princes were permitting this self-governance because it functioned well to enhance commerce, and that increased tax revenues. A few centuries later the same customs were influencing legislative codes in the new nation-states of continental Europe, and the common law and admiralty courts in England were relying on them as precedents in their written judgments. Many of the same rules, in modern form, are now found in negotiable instruments law, sales and contract law, maritime and shipping law, insurance law, and many other areas.

One important modern code—embodied in an international convention—is the *UN Convention on Contracts for the International Sale of Goods*. We will cover this in some detail later in the book. The code was written by legal scholars of commercial law from around the world, brought together over the course of many years by the *UN Commission on International Trade Law (UNCITRAL)*, located in Vienna. The code covers subjects similar to those in Article 2 of the *Uniform Commercial Code*, the primary body of sales law in the United States. However, the UN code applies to international sales between a buyer and seller in countries that are party to the convention. This includes most trading nations of the world today.

Another source of IBL are the nonbinding standards of conduct, or guidelines, published by respected



international organizations and disseminated world-wide. Examples are standards for the fair treatment and protection of workers in a developing country, a set of voluntary standards for socially responsible corporations, or recommendations for the protection of the environment. Although these are not technically “law” and may not be enforceable in courts of law, there exists a “soft enforcement” mechanism by virtue of their moral authority and the willingness of companies to comply in the face of public opinion. In some cases these norms do find their way into binding legal codes. Universal norms and standards are therefore considered a source of IBL. We will discuss a few of these later in this chapter.

Uniformity in International Business Law. Business functions best when law is clear and predictable. This lets people know the legal ramifications of future business plans and tells them their rights and obligations in advance of entering into business arrangements. This is especially true for firms operating in different countries. Complying with the maze of laws and regulations is difficult enough at home; it might be far too dangerous to embark on a business venture in a foreign country, if the laws there are unpredictable, arbitrary, unfair to foreigners, or just unknown. Despite its many differences worldwide, IBL has become more uniform between countries and regions of the world for several reasons:

1. The forces of free trade, economic integration, and the globalization of business have accelerated the need for greater uniformity in the law for international business.
2. Nations have had to cooperate in their legal responses to global issues, common problems, and technologies. For example, as intellectual property, ecommerce, and other technologies have grown in economic importance, IBL has adapted to keep pace.
3. Intergovernmental organizations such as the United Nations and the World Trade Organization have played an important role by producing uniform codes on many business subjects, from food safety to contract law.
4. International tribunals for dispute resolution have caused the greatest change in IBL in the modern era. They issue written reports and render judgments affecting national laws that do not conform to international treaties or customary international law.

5. The roles of private industry organizations and trade associations have had an important role in encouraging the growth of uniform IBL. One prominent example is the International Chamber of Commerce in Paris, which has developed standard terms for international business contracts, arbitration, and international banking. While not “law,” these customs and practices are regularly incorporated into business and banking contracts, and are relied on by business people and international lawyers and applied by courts in legal disputes.

Why International Business Law Retains Its National Character. Although IBL has become more uniform, there are important reasons why it remains diverse and “national” in character:

1. National courts interpret and apply IBL according to their own legal rules, case precedents, and histories.
2. Differences in national legal systems reflect different legal and regulatory approaches to business law. For example, legal systems may be based on the common law of English tradition, on the civil law of European, Scandinavian, or Latin American tradition, on state socialist law, on religious law, or on mix of these.
3. The level of socioeconomic development in a country influences its legal development. It depends, for example, if a country has an industrialized economy like the United States, if it is a developing country, or if it has an agrarian economy.
4. National attitudes toward economics affect attitudes toward law and regulation. For example, one country may have a strong tradition of private enterprise and a free market economy. Other countries may believe in greater government regulation, more government ownership of industry, and more control over business. Some countries may pursue free trade and investment policies, while others may take a protectionist approach.

Crimes Related to International Business

Another special issue in the field of international law is that of jurisdiction for crimes. While **jurisdiction** is the power of a court to act, criminal jurisdiction is the power of a court to hear a criminal case and to act over a defendant. Today jurisdiction has become an important international issue because just as business has become more international, so too has criminality.



We all understand that nations have jurisdiction over crimes that occur within their territorial borders—“territorial jurisdiction.” But what if a crime that affects citizens or their national interests within the country is committed outside of a country?

Transnational Organized Crime. Before we return to the question of jurisdiction, let’s mention two major types of international crime. One type is transnational organized crime. Examples include the illegal drug and firearms trade, smuggling, human trafficking, prostitution and sex crimes, cybercrime, counterfeiting, ocean piracy, money laundering, and similar crimes. This might be the work of the Russian or Sicilian mafias, the Japanese yakuza, Colombian drug cartels, Chinese triad, or one of many gangs that engage in organized crime at the international level—a serious issue for law enforcement.

Transnational Business Crime. Another type of international crime is transnational business crime, including crimes that occur incident to or in the course of legitimate business, and that either take place across national borders or have an effect in more than one country. Sometimes referred to as “white collar crime” or “economic crime,” these include bribery and corruption, tax evasion, customs fraud, criminal violations of export control laws, business fraud, financial crimes, criminal violations of environmental laws, securities laws, and antitrust laws. The perpetrator might be an individual business person or the corporate entity itself.

UN Convention against Corruption. The *UN Convention against Corruption* (2003) has 165 contracting parties, including the United States. It calls for nations to (1) criminalize the offering or giving of a bribe or undue advantage to a public official, including a foreign official, to influence his or her official acts or to obtain business; (2) criminalize money laundering (passing money through otherwise legitimate businesses or banks to disguise its illicit origins); (3) improve enforcement by changing national bank secrecy laws so that the illicit proceeds of crimes can be tracked, identified, and seized; and (4) establish corporate criminal liability for legal entities. Some of these concepts are already a part of the national laws of many countries, including the United States, but not of all countries. One positive effect of more uniform laws against bribery and corruption is that it would level the business “playing field,” allowing government

contracts to go to the most efficient companies worldwide or to those that produced the best product or service at the best price, instead of to the most corrupt companies located in countries with the most lax laws. American business and government leaders and others around the world recognize this positive benefit.

Criminal Jurisdiction and the Extraterritorial Reach of Domestic Law

In a world where national political and economic interests span the globe, it is more important than ever for countries to deal with transnational crime—to protect their interests and the interests of their citizens. To set the stage, consider these jurisdictional problems:

- Industry executives from competing firms in the United States meet on a golf course on a Caribbean Island to fix prices and divide up territories among them in the U.S. market. On what jurisdictional grounds can these executives be prosecuted in the United States?
- An American businessperson doing business in Kuwait pays a cash bribe to a Kuwaiti government or military official to obtain business. Can the U.S. government arrest and prosecute this American on his or her return home?
- An executive of a Canadian corporation knowingly causes the discharge of a toxic waste into a river that runs into the United States. It poisons most life in the river for miles downstream and renders the water unsuitable for use. Can the business executive be prosecuted for crimes in both countries?
- A citizen of Russia, living in London, attacks and disrupts a major computer network in the United States. Where can he or she be tried?

What would happen in these cases? There are several issues raised here: May a country pass laws affecting conduct outside its territory? May it exert jurisdiction over individuals or corporations outside its territory? And if so, does this include jurisdiction only over its own citizens who commit crimes abroad, or also over foreign individuals and foreign corporations? The answers to these questions are often “yes,” although it does depend on the facts of each case and the laws of each country involved.

The principle that a nation can project its laws—its jurisdiction—beyond its territorial borders is known as **extraterritoriality** or **extraterritorial jurisdiction**. It applies to both civil and criminal statutes, although our discussion here applies to criminal law. All countries have different views toward the use of extraterritoriality. Some countries, such as the United States, are more willing to project their laws to individuals in foreign countries than, say, Canada or the countries



of Europe. In the United States many criminal statutes affecting business apply extraterritorially. These include statutes on discrimination in employment, price-fixing and antitrust violations, securities laws, transportation of counterfeit films and other intellectual property, interference with a flight crew, trading with the enemy during the time of war, country embargoes, banking and financial crimes, bribery, and more.

We are not speaking of any one country becoming the world's police force. Extraterritorial jurisdiction does not mean that one nation's law enforcement officials can enter another to make arrests. Normally, it requires a measure of compromise and mutual assistance in law enforcement. Any attempt by one country to enforce its laws against a citizen of another country might be very controversial and viewed as a violation of a country's sovereignty. It can even prompt diplomatic or trade retaliation. As a result, courts say there is a presumption that national laws do not have extraterritorial reach, particularly where they conflict with international law or the laws of another nation. This helps to avoid conflicts in foreign relations. Extraterritoriality is least controversial when it is done by international agreement. A U.S. criminal statute may be applied extraterritorially if the language and history of the statute shows that Congress had intended for it to apply outside the United States. Jurisdiction must also be based on one of the following five basic principles: territoriality, nationality, the protective principle, passive personality, and universality.

Territoriality. Territoriality or **territorial jurisdiction** refers to a nation's jurisdiction over all persons (citizens and noncitizens), places, and property within the territory, airspace, or territorial waters of a country and to crimes committed on vessels flying that nation's flag. In the case of jurisdiction for crimes, subjective territorial jurisdiction exists where a crime was actually committed within the territory. It is the least controversial form of exerting state power because it does not directly interfere with the sovereignty of other nations. Objective territorial jurisdiction, also called the "effects" principle, exists where an act was committed outside a country's territory, but had a substantial effect inside the country. An example of objective territorial jurisdiction in criminal law is the prosecution of foreign citizens in U.S. courts for attempting to smuggle illegal drugs into the United States aboard a foreign-flag ship in international waters.

Nationality. Under the principle of **nationality jurisdiction**, individuals and corporate citizens owe duties to comply with the laws of their countries of nationality no matter where they are in the world. It is considered one of the obligations of citizenship. For example, an American banker in Hong Kong must comply with both Hong Kong and U.S. banking laws. If an executive order of the president states that no funds may be transferred to an account of a party believed to support international terrorism, then the American in Hong Kong is bound just as though he or she were in the United States. In another example, a country may tax the income of its citizens earned anywhere in the world, subject of course to certain rules set out in international treaties on income taxation.

Protective Jurisdiction. The protective principle allows jurisdiction over noncitizens for acts committed abroad on the basis of a country's need to protect its national security, vital economic interests, and governmental functions. **Protective jurisdiction** has been used as a basis of extraterritorial jurisdiction to prosecute terrorism, espionage, counterfeiting, making false statements to customs and immigration officers, and falsifying U.S. government documents (such as passports and visas). In one reported case, it was the basis for prosecuting a foreign citizen who conspired with an American to set up a sham marriage for the sole purpose of gaining entrance to the United States.

Passive Personality. **Passive personality** jurisdiction gives a country the right to hear cases stemming from crimes committed against their own citizens by noncitizens outside of their own territories. Passive personality is controversial because the only connection to the prosecuting nation may be the nationality of the victim. This raises the question of whether one nation should attempt to criminalize and prosecute acts committed by foreign citizens in foreign countries. Most countries, including the United States, have been reluctant to rely only on passive personality for jurisdiction and are willing to exercise it only in the case of heinous crimes, such as terrorism or other crimes with a significant nexus to the United States. One case, *United States v. Roberts*, 1 F. Supp. 2d 601 (E.D.La.1998), involved a sexual assault of an American minor aboard a cruise ship in international waters by a non-U.S. citizen working aboard. The ship was registered in Panama and was flying the flag of Liberia. On the perpetrator's prosecution in the United States, the court held that there was passive personality



jurisdiction because the ship had departed on its cruise from Miami; the ship's corporate officers were located in Miami; the company's stock was traded on the New York Stock Exchange; and a trial in the United States would not infringe the sovereignty of any other nation.

Universal Jurisdiction. Finally, the **universality** principle of jurisdiction permits any country to prosecute perpetrators of the most heinous and universally condemned crimes regardless of where the crimes occurred or the nationality of the perpetrators or victims. The main offenses universally punishable are piracy, slavery, war crimes, torture, genocide, crimes against humanity, and extrajudicial killings. One famous case of universality is Israel's 1961 public trial of Nazi war criminal Adolf Eichmann for holocaust atrocities committed in Europe during World War II. However, in more recent years, universality jurisdiction has not been widely used.

Interestingly, acts of terrorism have not been held to fall within universal jurisdiction. As a result, prosecution of a terrorist must be based on one of the other jurisdictional grounds. In *U.S. v. Ramzi Yousef*, 327 F.3d 56 (2d Cir. 2003), the defendant was convicted of conspiracy to bomb an American-flagged airline in Asia. On appeal he argued that the U.S. statute on destruction of aircraft could not be applied outside the United States. The court rejected the argument, stating that jurisdiction was consistent with a treaty and with three

of the five principles of international jurisdiction—objective territorial, protective, and passive personality. The court stated

First, jurisdiction . . . is consistent with the "passive personality principle" of customary international jurisdiction because [this] involved a plot to bomb United States-flag aircraft that would have been carrying United States citizens and crews and that were destined for cities in the United States. Moreover . . . jurisdiction is appropriate under the "objective territorial principle" because the purpose of the attack was to influence United States foreign policy and the defendants intended their actions to have an effect—in this case, a devastating effect—on and within the United States. Finally, there is no doubt that jurisdiction is proper under the "protective principle" because the planned attacks were intended to affect the United States and to alter its foreign policy.

The court went on to say that terrorism, unlike genocide, had not yet risen to a crime under customary international law. Noting the cliché that "one man's terrorist is another man's freedom fighter," the court felt that there was yet no universal definition of "terrorism" and thus universal jurisdiction could not apply.

In the following case, *United States v. Campbell*, a federal court permitted the prosecution in the United States of an Australian citizen arrested in India for a business crime committed against the U.S. government in Afghanistan. The court discusses extraterritoriality both under United States and international law.



United States v. Campbell

798 F. Supp. 2d 293 (2011) United States District Court (D.D.C.)

BACKGROUND AND FACTS

Campbell, an Australian citizen, was employed in the construction of health care facilities and schools in Afghanistan. The projects were funded by a U.S. government agency that extends financial and technical assistance to foreign countries to support U.S. foreign policy objectives. Campbell was on a panel that selected subcontractors to work on projects. The U.S. government alleged that Campbell demanded and received a cash payment in return for granting \$14 million worth of work to a subcontractor. The money had been paid by an undercover federal investigator in Kabul, Afghanistan, posing as an agent of the subcontractor. Campbell was indicted in the United States for bribery (18 U.S.C. Sec. 666), arrested in India several months later, and brought to the United States for prosecution. Campbell

moved for dismissal claiming that his prosecution was barred because the events occurred outside the United States, he is not an American citizen, prosecution would violate his due process rights, and his prosecution would violate international customary law.

ROSEMARY M. COLLYER, DISTRICT JUDGE

* * * Courts have long recognized a presumption against reading a statute to have extraterritorial effect. "It is a 'longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'" *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 130 S.Ct. 2869 (2010). [most citations omitted].

Despite this seemingly unequivocal pronouncement, the Supreme Court earlier cautioned that "the

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same rule of interpretation should not be applied to criminal statutes which are, as a class, not logically dependent on their locality for the Government's jurisdiction, but are enacted because of the right of the Government to defend itself against obstruction, or fraud wherever perpetrated, especially if committed by its own citizens, officers or agents." *United States v. Bowman*, 260 U.S. 94, 98, (1922). * * * *Bowman* concerned a . . . "conspiracy to defraud . . . the United States . . . after defendants submitted a false claim for fuel oil for one of its steamships." [T]he Supreme Court reasoned:

Crimes against private individuals or their property, like assaults, murder, burglary, larceny, robbery, arson, embezzlement, and frauds of all kinds, which affect the peace and good order of the community, must of course be committed within the territorial jurisdiction of the government where it may properly exercise it. If punishment of them is to be extended to include those committed outside of the strict territorial jurisdiction, it is natural for Congress to say so in the statute, and failure to do so will negative the purpose of Congress in this regard . . .

But the same rule of interpretation should not be applied to criminal statutes which are, as a class, not logically dependent on their locality for the Government's jurisdiction, but are enacted because of the right of the Government to defend itself against obstruction, or fraud wherever perpetrated, especially if committed by its own citizens, officers, or agents. Some such offenses can only be committed within the territorial jurisdiction of the government because of the local acts required to constitute them. Others are such that to limit their locus to the strictly territorial jurisdiction would be greatly to curtail the scope and usefulness of the statute and leave open a large immunity for frauds as easily committed by citizens on the high seas and in foreign countries as at home. In such cases, Congress has not thought it necessary to make specific provision in the law that the locus shall include the high seas and foreign countries, but allows it to be inferred from the nature of the offense. * * *

Mr. Campbell argues that his prosecution violates customary international law. "[I]nternational law itself imposes limits on the extraterritorial jurisdiction that a domestic court may exercise. It generally recognizes five theories of jurisdiction, the objective territorial, national, passive, protective and universal." *Tel-Oren v. Libyan Arab Republic*, 726 F.2d 774 (D.C.Cir. 1984). An act of Congress should not be construed in a manner that violates the laws of nations if a non-violative interpretation is possible. *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, (1993).

Here, the protective principal—specifically articulated in *Bowman*—supports the prosecution of Mr. Campbell. "The protective principle permits a nation to assert jurisdiction over a person whose conduct outside the nation's territory threatens the nation's security or could potentially interfere with the operation of its governmental functions." *United States v. Romero-Galue*, 757 F.2d 1147 (11th Cir. 1985); Bribery in connection with contracts backed by U.S. financing is illegal precisely because it implicates and adversely affects the interests and purse of the United States. The United States has the right "to defend itself against obstruction, or fraud wherever perpetrated." [*Bowman*]. The protective principle amply supports prosecution of Mr. Campbell in this Court.

Decision. Motion to dismiss is denied. The defendant's prosecution under this statute for bribery occurring outside the United States does not violate the principle against extraterritorial application of U.S. law because, under *U.S. v. Bowman* (cited above), the government has an interest in protecting itself from fraud wherever it occurs. The statute does not violate international customary law because it falls within the protective jurisdiction.

Comment. The court also held that because of the real harm done to the United States, there was a sufficient "nexus" or connection to the United States such that prosecution was not unreasonable or fundamentally unfair in violation of the defendant's constitutional rights.

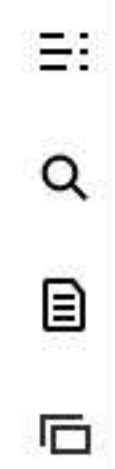
Case Questions

1. If Congress did not state in the statute that it applied outside the United States, how did the court arrive at its conclusion?
2. What is meant by the "*Bowman* Exception"?

INTERNATIONAL COURT OF JUSTICE

The most important international judicial body is the International Court of Justice, or ICJ. Formed in 1945 as the primary judicial arm of the United Nations, the

ICJ is the arbiter of international law disputes between nations—cases brought by nations, against nations. It sits at The Hague, Netherlands, and bases its work on the *Statute of the International Court of Justice*. The 15 independent judges are selected from the leading jurists and scholars of international law on a worldwide basis. Individuals and private corporations are not parties to



cases before the ICJ (although one nation may bring an action against another nation alleging a violation of the rights of one of their citizens under international law). In addition to dispute resolution the ICJ renders non-binding advisory opinions to the United Nations.

Specifically, the ICJ has jurisdiction over cases brought under the *UN Charter* or that involve a treaty, convention, international obligation, or question of international law. Jurisdiction over any nation is completely voluntary in that no nation must appear unless it consents to jurisdiction. Nations that agree in advance to submit certain types of cases to the ICJ are said to have submitted to **compulsory jurisdiction**, although this too is voluntary and may be withdrawn.

The ICJ's judgments are made public, and there is no appeal. The judgments are binding only on the parties to the case, and not to all nations of the world. They are enforced primarily on the basis of world public opinion, diplomatic pressure, and good faith of the countries involved. In a principle established in the *Case Concerning the Factory at Chorzów (Poland v. Germany, P.C.I.J., 1927)*, decided by the Permanent Court of International Justice, the forerunner of the modern ICJ, any violation of an international obligation requires the payment of financial reparations or damages. Typical cases heard by the ICJ have included land and maritime boundary disputes and the use of waterways; unlawful detaining of diplomats (e.g., Iran holding U.S. diplomats hostage in

1979); violations of sovereignty by neighboring armies (e.g., Uganda's plundering of the Democratic Republic of the Congo and the killing and torture of civilians from 1996 to 2001); violations of humanitarian law (e.g., Bosnia and Serbia from 1992 to 1995); violations of human rights (e.g., the ICJ's 2003 decision holding that the United States had violated the rights of 51 Mexican citizens on death row in the United States by not permitting them to have the assistance of the Mexican embassy in their defense).

Many of these decisions are highly controversial and, as would be expected, subject to criticism from many quarters. Many decisions cannot be enforced. For instance, in the above examples, Iran did not comply with the ICJ's judgment, Uganda will probably never pay the ordered \$10 billion in reparations, and the United States did not overturn the sentences of the Mexican nationals and, indeed, withdrew from the treaty on which the court's decision was based.

In the following case, Mr. Nottebohm was seeking diplomatic protection by Liechtenstein, of which he was a naturalized citizen, against the acts of Guatemala, where he resided. **Diplomatic protection** is the right of one nation to take diplomatic or judicial action to protect the rights of a person to whom it has granted nationality from a violation of international law by another nation. (*Case on Mavrommatis Palestine Concessions*, Judgment of Aug. 30, 1924 P.C.I.J.)



Nottebohm Case [Liechtenstein v. Guatemala]

Judgment of April 6th, 1955: I.C.J. Reports 4 International Court of Justice

BACKGROUND AND FACTS

Friedrich Nottebohm was born in Germany in 1881. He moved to Guatemala for business reasons in 1905 and lived there until 1943, except for business trips and visits to his brother in Liechtenstein. He remained a German citizen during that time. One month after Germany's invasion of Poland and the start of World War II in 1939, while visiting Liechtenstein, Nottebohm applied to become a naturalized citizen. Liechtenstein waived the three-year residency requirement. Nottebohm paid taxes and fees to Liechtenstein and filed the requisite forms, and Liechtenstein swore him in as a citizen and issued him a passport. Nottebohm returned to Guatemala in 1940. In 1943, Guatemala entered World War II, siding with the United States. Upon his return to Guatemala, Nottebohm was arrested as a German enemy

and turned over to the United States for internment. His property was seized by Guatemala. Nottebohm was released in 1946, but his property was not returned. Liechtenstein filed a "memorial" for diplomatic protection of its citizen, as the complaint is called, before the International Court of Justice, claiming that Guatemala had violated international law by refusing to recognize Liechtenstein as his country of nationality. Liechtenstein claims that it is entitled to damages.

JUDGMENT

... [I]nternational law leaves it to each State to lay down the rules governing the grant of its own nationality. * * * On the other hand, a State cannot claim that the rules it has thus laid down are entitled to recognition by another State unless it has acted in conformity with this general aim of making the legal bond of nationality

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accord with the individual's genuine connection with the State ...

According to the practice of States, to arbitral and judicial decisions and to the opinions of writers, nationality is a legal bond having as its basis a social fact of attachment, a genuine connection of existence, interests and sentiments, together with the existence of reciprocal rights and duties. It may be said to constitute the juridical expression of the fact that the individual upon whom it is conferred, either directly by the law or as the result of an act of the authorities, is in fact more closely connected with the population of the State conferring nationality than with that of any other State. * * *

Naturalization is not a matter to be taken lightly. To seek and to obtain it is not something that happens frequently in the life of a human being. It involves his breaking of a bond of allegiance and his establishment of a new bond of allegiance. It may have far-reaching consequences and involve profound changes in the destiny of the individual who obtains it. It concerns him personally, and to consider it only from the point of view of its repercussions with regard to his property would be to misunderstand its profound significance. In order to appraise its international effect, it is impossible to disregard the circumstances in which it was conferred, the serious character which attaches to it, the real and effective, and not merely the verbal preference of the individual seeking it for the country which grants it to him. * * *

At the time of his naturalization does Nottebohm appear to have been more closely attached by his tradition, his establishment, his interests, his activities, his family ties, his intentions for the near future to Liechtenstein than to any other State? * * *

At the date when he applied for naturalization Nottebohm had been a German national from the time of his birth. He had always retained his connections with members of his family who had remained in Germany and he had always had business connections with that country. His country had been at war for more than a month, and there is nothing to indicate that the application for naturalization then made by Nottebohm was motivated by any desire to dissociate himself from the Government of his country.

He had been settled in Guatemala for 34 years. He had carried on his activities there. It was the main seat of his interests. He returned there shortly after his naturalization, and it remained the centre of his interests and of his business activities. He stayed there until his removal as a result of war measures in 1943. * * *

In contrast, his actual connections with Liechtenstein were extremely tenuous. No settled abode, no prolonged residence in that country at the time of his application for naturalization: the application indicates that he was paying a visit there and confirms the transient character of this visit by its request that the

naturalization proceedings should be initiated and concluded without delay. No intention of settling there was shown at that time or realized in the ensuing weeks, months or year-on the contrary, he returned to Guatemala very shortly after his naturalization and showed every intention of remaining there. * * * Furthermore, other members of his family have asserted Nottebohm's desire to spend his old age in Guatemala.

These facts clearly establish, on the one hand, the absence of any bond of attachment between Nottebohm and Liechtenstein and, on the other hand, the existence of a long-standing and close connection between him and Guatemala, a link which his naturalization in no way weakened. * * * It was granted without regard to the concept of nationality adopted in international relations.

Naturalization was asked for not so much for the purpose of obtaining a legal recognition of Nottebohm's membership in fact in the population of Liechtenstein, as it was to enable him to substitute for his status as a national of a belligerent State that of a national of a neutral State, with the sole aim of thus coming within the protection of Liechtenstein but not of becoming wedded to its traditions, its interests, its way of life or of assuming the obligations other than fiscal obligations and exercising the rights pertaining to the status thus acquired.

Guatemala is under no obligation to recognize a nationality granted in such circumstances. Liechtenstein consequently is not entitled to extend its protection to Nottebohm vis-à-vis Guatemala and its claim must, for this reason, be held to be inadmissible.

Decision. Guatemala was not required to recognize the citizenship granted by Liechtenstein in a way that did not follow well-established principles of international law.

Comment. Nottebohm was a naturalized citizen of Liechtenstein and citizenship is a domestic law concept. He was a citizen for purposes of the laws of Liechtenstein when in Liechtenstein. Nationality, however, is an international law concept, important in the international arena, and Guatemala's recognition of nationality was based on international law.

Case Questions

1. May individuals bring an action against a nation at the ICJ?
2. On what basis did Liechtenstein file this action?
3. Although a nation can determine its own criteria for citizenship, must that be recognized by other nations?
4. Do you feel that this judgment interfered with Liechtenstein's sovereignty? Why or why not?
5. Would this case be considered one of international public or private law?



International Criminal Court. The *Rome Statute of the International Criminal Court* (124 parties as of 2017) is a 2002 treaty that created the International Criminal Court, which sits at The Hague, Netherlands. It is independent, and not a part of the United Nations. The Court hears three types of crimes: genocide, crimes against humanity (attacks against civilians through murder, slavery, forced deportations, torture, rape and sexual violence, disappearances, apartheid and other persecutions on the grounds of religion, race, ethnicity, national origin, political beliefs, or gender), and war crimes. Terrorism and drug trafficking are not within the Court's jurisdiction. Jurisdiction applies to nationals of a country that has ratified the treaty, even if the nationals were acting in an official (government) capacity. There is no statute of limitations—perpetrators can be apprehended and tried any time during their lifetimes. The Court does not have exclusive jurisdiction over these crimes, as the right of any nation to prosecute genocide, crimes against humanity, and war crimes still exists under international customary law and domestic law.

The United States, Russia, China, India, and Iran are among the countries that have not joined the Rome Convention. Many critics believe that the court impinges on national sovereignty, that it could subject government and military leaders to prosecutions solely on political grounds, and that it lacks fair procedures and appeal mechanisms.

ETHICS, SOCIAL RESPONSIBILITY, AND CODES OF CONDUCT

In international business, the law is a floor above which our ethical conduct should rise. Lawyers can tell us what the law is, or what conduct is lawful or unlawful. They can do a good job of telling us what a likely fine or prison sentence will be for commission of a crime, and they are fairly good at estimating future damages to injured consumers, or anyone else with a legal claim against us. But it would be difficult for anyone to tell us what is ethical, or socially responsible, or right or wrong. Compliance with the laws of all countries in which we work is difficult enough. Rising to a higher ethical standard is even harder. After all, ethics are based on one's own experience, knowledge, culture, beliefs, and personal value system. And in international business, what is ethical in one culture or in one

country might not be ethical in another. However, it is easier to evaluate our own notions of right and wrong, and to conform to a higher international standard, when there is a growing international consensus on business ethics and social responsibility expressed in international norms. Norms and standards—the conscience of world public opinion—can be found in codes of conduct drafted by public and private international organizations, and by companies themselves. Although the codes are voluntary and nonbinding, they do have the soft enforcement mechanisms that we spoke of earlier in the chapter. They are enforceable because each corporate stakeholder has an interest in them being enforced, as those stakeholders are not just the owners and directors, but also the subcontractors and business partners, customers, employees, managers of large investment funds and other investors, and the public. Indeed, taken together, these codes contain a framework for promoting ethical conduct and social responsibility in international business.

International Business and Human Rights

International human rights law protects individuals and groups from the acts of governments that violate their civil, political, or human rights. Sources of human rights law includes customary international law and many international conventions. Today human rights law issues are seen as a broader concept that have ramifications in international business, and especially to large, multinational firms. The *Guiding Principles for Business on Human Rights* (2011), published by the UN Office of the High Commissioner for Human Rights, addresses this. Although not a legally binding document, it does reflect the thinking about human rights and business: Article 23 states,

In all contexts, business enterprises should

- (a) comply with all applicable laws and respect internationally recognized human rights, wherever they operate
- (b) seek ways to honor the principles of internationally recognized human rights when faced with conflicting requirements
- (c) treat the risk of causing or contributing to gross human rights abuses as a legal compliance issue wherever they operate

We started this section with the idea that the law is a floor for our ethical conduct. This is reflected in a quote from the *Guiding Principles*.

The responsibility to respect human rights is a global standard of expected conduct for all business enterprises wherever they operate. It exists independently of States' abilities and/or willingness to fulfill their own human rights obligations, and does not diminish those obligations. *And it exists over and above compliance with national laws and regulations protecting human rights.*

International Labour Organization

The International Labour Organization (ILO), located in Geneva, was founded in 1919 and became a part of the UN system in 1946. The objectives of the ILO are to bring together government, industry, and labor groups, with a focus on developing countries, to help promote the rights of workers, create decent and beneficial employment opportunities, eliminate child labor, and help foster ideas and the means for the economic and social protection of the poor, the elderly, the unemployable, women, and children. The governing body of the ILO is made up of individual representatives of government, industry, and labor.

Perhaps the most important undertaking of the ILO has been the creation of international labor standards, embodied in 188 conventions and almost 200 non-binding "recommendations" for minimum standards of basic workers' rights. These include the right of workers to freely associate, the right to organize and bargain with employers collectively, abolition of forced labor and child labor, creation of a safe working environment, protection of migrant workers and workers at sea, elimination of discrimination at work, equality of opportunity and treatment for men and women workers, and other standards addressing workplace health and safety. ILO conventions are legally binding on a member nation only when ratified by the member nation's government. Not all countries have ratified all conventions. For example, the United States has ratified only 14 ILO conventions.

The OECD Codes of Conduct

The Organisation for Economic Cooperation and Development (OECD), located in Paris, is an intergovernmental organization whose members consist of national governments, with nongovernmental organizations joining as observers. The OECD comprises 35 industrialized countries, including the United States, Canada, Mexico, Israel, Japan, Korea, Turkey, and the European countries. Some of the formerly communist countries of Eastern Europe are also members.

The *OECD Guidelines for Multinational Enterprises* are a set of voluntary recommendations to multinationals encouraging responsible business conduct when they operate in host countries. They cover the entire range of business ethics and social responsibility issues. They are not legally enforceable, but are well known and reflect the consensus of many governments. They encourage self-enforcement through accountability, reporting, and internal controls, such as encouraging "whistle-blowing" by employees who become aware of corporate violations. The guidelines were first issued in 1976 and revised in 2000. A few representative standards include those for employment, environmental protection, corruption, consumer privacy, and diffusion of technology in developing countries. One interesting environmental standard calls on countries to "not use the lack of full scientific certainty as a reason for postponing measures to prevent or minimize serious damage to the environment."

You can find other OECD recommendations in specific areas in the *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* (1997), *Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices Across Borders*, and the *Guidelines for Consumer Protection in the Context of Electronic Commerce*.

United Nations Global Compact

The **UN Global Compact** is a partnership of international companies, public interest groups, and UN agencies who pledge to support a set of voluntary principles on human rights, labor standards, the environment, and corruption. The ten core principles are presented in very general terms. For instance, one states that, "Businesses should make sure that they are not complicit [with governments] in human rights abuses." Another states that, "Businesses should support a precautionary approach to environmental challenges." Of course, the *Global Compact* is not without criticism from those who are generally critical of all UN activities. However, the core principles are merely a statement of the most basic, universally recognized principles of corporate social responsibility. According to the United Nations, as of 2017 there were 9,300 corporate signatories from around the world, although reception of the compact has been greatest in Europe (56 percent of signatories), Latin America (18 percent), Asia (14 percent), and North America (5 percent).



CERES Principles

The **Coalition for Environmentally Responsible Economies**, or CERES, is a private, mostly American network of environmental groups, socially conscious investors, and companies committed to following the **CERES Principles** of environmental and social accountability. One provision of the CERES Principles requires that in selecting a board of directors the company will look for individuals with demonstrated environmental commitment, and the CEO and directors will take responsibility for the firm's environmental policy.

Corporate Codes of Conduct

In recent years, many companies have had an increased interest in enacting their own codes of conduct. There are surely many reasons for a company doing this. It might be seen as good business, in that it creates goodwill with customers and investors. Some might see it as an opportunity to foster an ethical and responsible attitude in their employees while others may view it as an opportunity for self-regulation that could forestall the enactment of more restrictive national laws and regulations. In the United States, the guidelines for sentencing corporate offenders allow for reduced fines and sentences if a defendant can show that it has had a **code of conduct** and compliance program to reduce the likelihood of criminal conduct.

A good example of a corporate ethics code is the *Levi Strauss & Co. Global Sourcing and Operating Guidelines*. It is generally recognized as the first code of conduct created by a multinational corporation and made applicable to its foreign suppliers. While these guidelines address issues important to an apparel company like Levi Strauss, their basic ideas can be applicable to any firm that does business through a global supply chain or with a supplier or contractor in a developing country in an industry that is highly labor intensive.

The guidelines include the *Business Partner Terms of Engagement*, representing an effort by Levi Strauss to control the activities of its more than 500 overseas contractors and suppliers. In the 1990s, the company discovered (as did many U.S. apparel and footwear makers) that a large number of its subcontractors were maintaining substandard working conditions or using child labor in some fashion. The company not only reacted quickly to stop these practices, it began developing guidelines to end them. The *Business Partner Terms of Engagement* sets out, in more than

70 pages, the minimum standards for the fair treatment of workers that must be met by any foreign firm wishing to supply or contract with Levi Strauss. It addresses specifics such as wages, working hours, the use of corporal punishment, and how to treat workers on the factory floor. Levi Strauss provides its suppliers with manuals and training programs to implement its standards. The company also makes public its list of all overseas factories producing Levi Strauss products.

Other apparel companies, with similar codes, include The Gap (*Code of Vendor Conduct*), The Limited (*What We Stand For*), Sara Lee (*Global Business Standards and Global Standards for Suppliers*), Wal-Mart (*Ethical Standards Program*), and many others. It is generally agreed that for any company's code of conduct to be effective it must be communicated to its employees, become a part of its corporate culture, include disciplinary measures and other methods for ensuring compliance, include a system for measuring its effectiveness, and provide a means of shareholder and public accountability.

COMPARATIVE LAW:
DIFFERENCES IN NATIONAL
LAWS AND LEGAL SYSTEMS

The study of "comparative law" refers to the study of differences in national laws and legal systems. These differences cover the entire range of law—marriage and family law, business law, liability for wrongful torts, crimes, and more. There are also differences in legal procedures, the role of legislation and case law, the function of lawyers and judges, the conduct of trials, the use of legal remedies in civil cases, and punishments in criminal cases. These differences are rooted deep in national culture, politics, economics, and especially history, and often are the result of centuries of gradual evolution, combined with rapid change caused by wars, revolution, technological change and political turmoil. The opening of world markets for commerce, trade, investment and labor—globalization—has long influenced the development of national law, and this can be seen from the time of the earliest civilizations to the modern era. There are no better examples of how legal systems adapt to change than in Japan and China, both countries that opened to the world after long periods of isolation.



Modern Japan: An Example of Legal Change

Japan's earliest legal records date back to at least 500 A.D., and for most of its history it was a feudal system whose laws were based on early Confucian and Buddhist principles taken from China. Japan had been largely closed to Westerners and Western trade, except for some trade with the Dutch until the mid-nineteenth century. As Japan opened its doors to trade, it recognized the importance of modernizing its legal system. Foreign merchants and traders had to be able to understand Japanese law and be assured that it was predictable and not arbitrary. Foreigners had to have confidence that their legal rights would be recognized and enforceable, and that there were legal mechanisms for resolving disputes. Many of these legal changes were required by treaties or trade agreements with foreign countries, as has often been the case throughout history and to this day. During the 1860s, Japan broke with its feudal past and began a national effort to modernize its legal system. New law schools opened, and law professors were exchanged with foreign institutions. Legal scholars were sent around the world, primarily to Europe, to study foreign legal codes and to find ways to adapt these to Japan. By the end of the nineteenth century, Japan had remade its legal system largely in the image of the European countries, primarily of Germany. The result was the adaptation of European civil law principles to Japanese culture and society. These included written codes in commercial law, real property law, family law, criminal law, and others, as well as procedures for trials and deciding cases.

After World War II, the United States became the major influence in Japan, resulting in a parliamentary democracy and bill of rights, while preserving the symbolic role of the Emperor. The United States also revised many of Japan's business laws. To this day, it is safe to say that Japan's laws are an amalgamation of European civil and criminal law, American constitutional and administrative law, and Japanese cultural values.

Legal Changes in China

The legal system of the People's Republic of China (China) underwent its first modern change at the dawn of the twentieth century. As in Japan in that period, a legal system developed that borrowed from the European experience. However, that changed after World War II, with the communist takeover and the introduction of Marxist theory. After the war, China adopted a system of centrally controlled state planning

of economic activity. There were few market mechanisms to regulate the factors of production, the use of natural resources, or pricing. State policy, and not consumer demand, dictated how many and what kinds of goods were produced. Clearly, the role of law in such a system was different from what we today would think. For example, in such a system there was little need for private contracts or for a body of contract law to protect private rights. Law was viewed as a tool of protecting socialist economic principles. Contract law ensured that state doctrine was followed and that commitments made to and between state agencies—such as a contract to deliver ore from a state-owned mine to a state-owned mill—were upheld. Interestingly, in sharp contrast to what Western lawyers were accustomed to, “breach of contract” actions more closely resembled quasi-criminal prosecutions for breaching one's obligation to the state. In the West, when a party breaches a contract, a court typically awards damages to the nonbreaching party as compensation. In China, the focus at that time was on compelling a breaching party to do what it had promised, including fines and punishment.

China's business laws changed remarkably during the last quarter of the twentieth century. As it opened its doors to Western business in the 1970s and 1980s, like Japan before it, China saw that modern commercial laws were essential to attracting buyers to Chinese-made goods and foreign investment in the Chinese economy. Today its legal system is based on both socialist and Western legal principles. China has today enacted many modern codes, such as those in banking, joint venture and company law, intellectual property, securities, foreign trade regulation, consumer protection, taxation, transportation, corruption, and contract law, some of which will be discussed later in this book. These laws reflect China's transition from a purely socialist state to that of a mixed economy—partially state owned, partially privately owned, albeit still with great state control. There is little doubt that the development of China's legal system, although it is not nearly as sophisticated and complex as that of the United States and Western nations, went hand-in-hand with its becoming a global manufacturing and economic giant.

Modern Legal Systems of the World

While it is obvious that laws can differ from country to country, the differences in legal systems are largely differences in the role of legislatures in enacting statutes or codes, the role of judges and the courts in applying



and interpreting the law, and in legal procedures. Here we briefly describe the most widespread modern legal systems found in the world today. These are the common law, civil law, Islamic law, and mixed systems that incorporate characteristics of more than one.

Origins of Civil Law Systems

Those countries with a predominantly **civil law** system include most of Eastern and Western Europe, Scandinavia, Latin America, Japan, and Russia, among others. Countries with a **mixed civil law** system include much of Africa and a few parts of Asia (with tribal or customary law), and Pakistan and many Middle Eastern countries (with Islamic law). China's system is largely civil, mixed with principles of socialist economic law and traditional Confucian values.

While the term "civil law" can have several different meanings, the most common meaning to Americans is in reference to the laws affecting private rights and remedies, such as contract law, family or inheritance law, or tort law. However, in the context of comparative law and as used in this chapter, *civil law* refers to those modern legal systems that are derived from ancient Roman law.

Early Roman Law and Its Revival. The early Romans had a penchant for writing, or most likely carving, very simple laws into bronze or marble tablets and placing them in public places. These became the earliest written Roman codes. Rome's conquering armies carried Roman law far and wide. Eventually, Rome had amassed thousands of edicts, rules, and penalties created by generations of emperors. Over the centuries, they had become unwieldy and outdated. By 529 A.D., Rome had long ceased to be the capital of the Roman Empire, and the Emperor Justinian ruled the Eastern Roman Empire from his seat of government in Byzantium (modern Istanbul). In that year, Justinian presided over the rewriting of Roman law, which was condensed and compiled into one code, known as the **Justinian Code**. It classified legal rules and organized them into a logical system that created a "body" of law, in a form that could be learned, understood, and applied. However, Rome had already been overrun by Germanic hordes in the West. The Roman Empire had been lost, and in time, Justinian's code was forgotten—some say lost—almost forever.

Hundreds of years later, around 1100 A.D., copies of Justinian's long-lost code were discovered. Legal scholars from Italy and around the world began to take great

interest. They were impressed by how comprehensive it was and how it had arranged legal principles in an orderly and systematic manner. For centuries, Roman law was taught only as an academic discipline, primarily in Italian universities.

Centuries later, the Emperor Napoleon found the clarity and organization of the Roman system to be very appealing, and in 1804, he used Roman principles as the basis for consolidating all French law into one code. The **Napoleonic Code** was soon translated into almost every language, and adaptations of it spread throughout Europe and the world. It was the model for the new legal systems of Latin America on their independence. The legal systems in civil law countries still have their distant roots in Roman law.

In the nineteenth century Germany started work on a uniform code, also closely based on the organization of Roman law. In 1900, it enacted its *Bürgerliches Gesetzbuch*, the German civil code, as well as codes of commercial law and criminal law. The *Bürgerliches Gesetzbuch* is still the codified law of Germany to this day, having been amended through the twentieth century, and most recently in 2002. These two codes have been an important influence on the growth of civil law internationally. The German legal codes influenced the legal systems of Japan, China, Portugal, Brazil, and many other countries. Today, the civil law system is the predominant legal system in the world. Despite common legal heritage, there still are many national differences in the civil law systems. Scotland, South Africa, and the Scandinavian countries have variations of the traditional civil law system.

Origins of Common Law Systems

It amazes many American students to learn that English law originated in the Normandy region of France via the Norman Conquest of 1066. While many English and American legal terms come from French and Latin (after all, the Romans had conquered Gaul and Britain), the revival of Roman law in the eleventh and twelfth centuries that occurred on the European continent completely skipped Britain, which by then was branching off on its own legal track.

The job of describing one thousand years of English legal history in a few paragraphs is not easy. But it is an interesting tale. Anglo-Saxon law governed much of Britain from the fall of the Roman Empire until the Norman Conquest in 1066. Law came partly from the early kings and their councils and partly

from local custom. By 1066, legal disputes were being heard by Anglo-Saxon courts. There were early forms of trial, but there was no evidence or factual proof offered. There were no witnesses as we know them today. Proof at trials was based on the ceremonious recitation of a formal oath by the parties and their "oath helpers." The higher one's social status, the fewer helpers he needed. One mistake in the recitation, one slip of the tongue, and the accused was deemed to have lied, and was thus guilty by divine intervention. There was also trial by ordeal—perhaps by placing a hand in fire. Again, by divine intervention, if the hand became infected over time, the accused had lied. If the hand healed, he had told the truth. It was primitive and archaic. Yet another method of proof was "trial by battle." Needless to say of course, justice was not kind to some.

Then, after 1066, William the Conqueror introduced a political and economic system commonly called *feudalism*. All land was parceled out to his closest followers, the lords, who in turn gave parcels to subtenants, who in turn did the same. Each took his land with certain rights and in return for certain duties owed to the tenant above, or to his lord. The duties might be farming, knight service, or castle guard, for example. Even the church received land in return for prayers. The very first laws developed by William were created to enforce feudal rights in land.

While European feudalism no longer exists, the legal system that William and subsequent English kings introduced to England does. They decreed that all justice flowed from the king, and from the King's Court, or *Curia Regis* (the king's closest advisors, sitting at Westminster). Justice from the king was obtainable through one of many formal, written writs. Soon traveling judges were sent into the countryside to hold court. Eventually, the king's judges brought with them a new concept, trial by jury.

As one would expect, the popularity of trial by jury over trial by ordeal or battle led to the eventual demise of the old Anglo-Saxon courts. As the king's itinerant judges decided cases, they recorded their decisions and shared them with other judges of the King's Court. Judges could now justify their decisions by citing the decisions of other judges in similar cases. A "common" body of law resulted. Thus began the **common law system** that we know today—where the reasoned decisions of judges become the law of the case, a legal precedent that binds judges in deciding similar cases in the future.

This is expressed in the common law doctrine of *stare decisis*, meaning that courts should "let the decision stand" unless it is overruled by a higher authority.

The common law spread with the British Empire. Examples of common law countries today include Australia, Canada, Ghana, Great Britain, the United States, and many Caribbean island nations. India has a mixed system that is largely based on the common law. Even many civil law nations have adopted common law principles.

Differences between Modern Civil Law and Common Law Countries

Civil law and common law systems today have many differences and many similarities. Both systems rely on legislative codes, or statutes, as the primary source of law. However, in civil law countries the legal codes are more comprehensive, establishing general principles that are interpreted by judges and applied to the case before them. Where there are gaps in the code law, the judge will draw from the code's principles and doctrine to decide a case. The courts in both systems issue judicial decisions. While civil law judges often cite earlier court decisions that they consider representative of settled law, they are not bound to follow them. Civil law judges do not render opinions that make new law in the form of binding precedent, as do common law judges. It can be said that civil law lawyers are more trained in the interpretation of code law, while common law lawyers are more skilled in using case precedent to develop legal arguments for their clients. It is probably true that researching case law is far more difficult in common law systems, where lawyers must find and piece together common legal principles from unrelated cases and justify the application of those principles to their client's case. Of course, in common law countries, case decisions can always be overridden by statute, as long as the statute does not violate a constitutional doctrine.

The role of judges is also different in civil law countries. The professional judge is schooled for a career as a judge, not a lawyer. In criminal cases, judges take a more inquisitorial role, as do the lawyers for both sides, in an investigative search for the truth. The process is less adversarial than in common law countries. In other legal matters, such as contract or tort cases, judges do the work that both judge and jury would do in common law countries. Unlike common law judges, they can undertake their own investigations of the facts and



decide what witnesses to call and what questions to put to them. Much of this is done in writing. In common law countries, the judge is an arbiter between opposing counsel, ruling on what evidence or testimony is admissible, and maintaining a fair trial.

Islamic Law

Over 20 percent of the world's population is Muslim. They are located in some of the very richest and very poorest countries on earth, in the Middle East, Northern Africa, and Central and Southeast Asia. The largest Muslim populations are in Indonesia, Pakistan, India, Bangladesh, Turkey, Iran, and Egypt. In less than 50 years, the Muslim countries of the Middle East have gone from the age of antiquity to the modern age of information, technology, and oil wealth.

The poorer Muslim countries are undergoing tremendous social and political change. Some have adopted Western practices in business, society, and to a lesser extent, family life. Others have returned to strict Islamic principles. Some Muslim countries give limited rights to women; others abide by strict fundamentalist principles. For example, in Saudi Arabia unmarried women are the wards of their fathers, and widowed women are the wards of their sons.

All Muslim countries seem caught in the political, social, and religious struggle between the Western nations and Islamic fundamentalism. Because of the importance of the Muslim countries today, business students should have some understanding of their basic laws.

Most Muslim countries today have modern legal systems, based on civil law or common law, mixed with principles of Islamic law. Islamic law is known as *Sharia* (or *Shari'ah*), meaning "divine law." It is derived from the Koran (*Qur'an*), and from the *sunna*. The Koran is the main religious book of the Islamic religion that expresses fundamental Islamic values. The *sunna* is the written record of the teachings and actions of the prophet Muhammad. In addition, Islamic jurists and scholars qualified to interpret the scriptural sources have produced opinions known as *fiqh*. An understanding of the *Sharia* requires reference to the *fiqh* for guidance. Islamic judges do not issue written opinions with the force of law, and they are not bound by the precedents of other courts. They are attempting to seek the truth, the divine word of God.

Saudi Arabian Legal System. An example of a strict Muslim country that is governed by *Sharia* is Saudi

Arabia. It is a monarchy and all laws are decreed by the King, in consultation with his highest ministers, in accordance with *Sharia*. The basic law sets out very general legal principles. For example, Article 41 states, "Foreign residents in the Kingdom of Saudi Arabia shall abide by its regulations and shall show respect for Saudi social traditions, values, and feelings."

All Saudi citizens must be of the Muslim faith. Serious crimes are punishable by capital punishment, stoning, amputations, or floggings. Rape, theft, the possession or use of alcohol, fornication, and adultery are serious crimes. Drug smuggling can be punishable by death. The *Sharia* courts hear cases involving crimes, family matters, property, and torts. In the last few years, Saudi Arabia has enacted new business regulations on product labeling, insurance, foreign investment, corporate income tax, trademarks, and others. These are considered to supplement Islamic law and must never conflict with it. Commercial and business disputes are heard by special commissions for grievances appointed by the King.

Pakistani Legal System. Other Muslim countries that had been colonized by Western nations in past centuries, such as Pakistan, have closer historical ties to Western legal systems. Pakistan's legal system has been influenced by the British, but is governed in part by Islamic principles. Today, Pakistan has a modern, written constitution, with a bill of rights that has some language that is similar to the American Constitution. It does declare Islam as the state religion.

Pakistan has secular civil and criminal courts, as well as a *Federal Shariat Court*, which has the power to invalidate any public law if it violates Islamic law. Appeals go to the Supreme Court of Pakistan.

The case of *M. Aslam Khaki v. Syed Muhammad Hashim* (2000) illustrates the great differences between banking and finance in Western nations and Islamic law nations. The Muslim countries have both international banks and Islamic banks. Islamic banks abide by *Sharia* law that prohibits the payment of interest on loans and deposits (although they do have alternative forms of compensation that substitute for interest). In its decision, the Supreme Court of Pakistan struck down the use of interest on all loans and bank deposits (including personal loans, commercial and corporate loans, and interest paid by the government on foreign loans). In 2002, the same court reconsidered its opinion, citing errors, and ruled that invalidating the payment of interest to



non-Muslims would “pose a high degree of risk to the economic stability and security of Pakistan.” Given that there are now many purely Islamic banks in the

Muslim world that follow Islamic law, cases like this one could have a tremendous effect on international business worldwide.



M. Aslam Khaki v. Syed Muhammad Hashim

Shariah Appellate Bench PLD 2000 SC 225 Supreme Court of Pakistan (2000)

BACKGROUND AND FACTS
This case illustrates a classic case of the conflict between Islamic law and modern business. In 1991, the Federal Shariah Court of Pakistan declared the payment of interest (*riba*) by banks on loans and deposits to be contrary to Islamic law. During the 1990s, Pakistani banks adopted many banking techniques to avoid the payment of interest, such as equity investments, profit sharing, and service charges. The government, together with several banks, brought this appeal to the Supreme Court of Pakistan. The court's entire opinion was 1,100 pages long. Below are excerpts from the individual opinion of Maulana Justice Taqi Usmani, an Islamic scholar trained in strict *Sharia* law. As you read, consider the political overtones of the opinion and the economic analysis of interest that would be considered contrary to Western, capitalist economic theory.

MAULANA JUSTICE TAQI USMANI
40. Imam Abubakr Al-Jassas (D.380 AH) in his famous work *Ahkamul Qur'an* has explained *riba* in the following words: “And the *riba* which was known to and practiced by the Arabs was that they used to advance loan in the form of *Dirham* (silver coin) or *Dinar* (gold coin) for a certain term with an agreed increase on the amount of the principal advanced.”
138. Firstly, money (of the same denomination) is not held to be the subject-matter of trade, like other commodities. Its use has been restricted to its basic purpose, i.e., to act as a medium of exchange and a measure of value.
139. Secondly, if for exceptional reasons, money has to be exchanged for money or it is borrowed, the payment on both sides must be equal, so that it is not used for the purpose it is not meant for, i.e., trade in money itself.
140. Imam Al-Ghazzali (d. 505 A.H.) the renowned jurist and philosopher of the Islamic history has discussed the nature of money in an early period when the Western theories of money were non-existent. He says: “... And whoever effects the transactions of interest on money is, in fact, discarding the blessing of Allah and is committing injustice, because money is created for some other things, not for itself.” * * *
151. This is exactly what Imam Al-Ghazzali had pointed out nine hundred years ago. The evil results of

such an unnatural trade have been further explained by him at another place, in the following words: “*Riba* is prohibited because it prevents people from undertaking real economic activities. This is because when a person having money is allowed to earn more money on the basis of interest, either in spot or in deferred transactions, it becomes easy for him to earn without bothering himself to take pains in real economic activities. This leads to hampering the real interests of the humanity, because the interests of the humanity cannot be safeguarded without real trade skills, industry and construction.”
153. Another major difference between the secular capitalist system and the Islamic principles is that under the former system, loans are purely commercial transactions meant to yield a fixed income to the lenders. Islam, on the other hand, does not recognize loans as income-generating transactions. They are meant only for those lenders who do not intend to earn a worldly return through them. They, instead, lend their money either on humanitarian grounds to achieve a reward in the Hereafter, or merely to save their money through a safer hand. So far as investment is concerned, there are several other modes of investment like partnership . . . which may be used for that purpose. The transactions of loan are not meant for earning income.
159. Once the interest is banned, the role of “loans” in commercial activities becomes very limited, and the whole financing structure turns out to be equity-based and backed by real assets. In order to limit the use of loans, the *Shar'iah* has permitted to borrow money only in cases of dire need, and has discouraged the practice of incurring debts for living beyond one's means or to grow one's wealth. * * *
160. Conversely, once the interest is allowed, and advancing loans, in itself, becomes a form of profitable trade, the whole economy turns into a debt-oriented economy which not only dominates over the real economic activities and disturbs its natural functions by creating frequent shocks, but also puts the whole mankind under the slavery of debt.
* * *
164. Since in an interest-based system funds are provided on the basis of strong collateral and the enduse of the funds does not constitute the main criterion for financing, it encourages people to live beyond

continues



continued

their means. The rich people do not borrow for productive projects only, but also for conspicuous consumption. Similarly, governments borrow money not only for genuine development programs, but also for their lavish expenditure and for projects motivated by their political ambitions rather than being based on sound economic assessment.

204. The basic and foremost characteristic of Islamic financing is that, instead of a fixed rate of interest, it is based on profit and loss sharing. We have already discussed the horrible results produced by the debt-based economy. Realizing the evils brought by this system, many economists, even of the Western world are now advocating in favor of an equity-based financial arrangement.

Decision. Interest on the use of money is unjustified and unearned income. A financial system based on the

lending of money for interest is unjust and contrary to Islamic law. Equity investments are lawful where all parties share the risk of profit and loss.

Comment. The Islamic banking community in many countries has been innovative in developing lending and banking programs that they feel are both in keeping with Islamic principles and adaptive to modern banking.

Case Questions

1. What is *riba*? Why is *riba* not permitted pursuant to the *Sharia* law?
2. What would the effect be on Pakistan if the decision were implemented in Islamic banks?
3. In what other ways have culture and religion influenced modern legal systems?

CONCLUSION

Although international law is rooted in centuries of customary law and treaties, it affects modern international relations and international business every day. It affects the movement of people, goods, and money across national borders. Virtually every area of international trade, foreign investment, and intellectual property rights is governed by at least one international convention. International law offers solutions to some of humankind's greatest challenges: human rights abuses by rogue governments, pollution that knows no national boundaries, transnational crimes, international

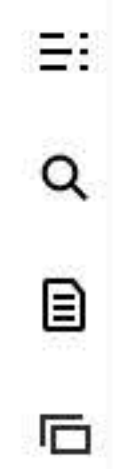
terrorism, and more. However, international solutions depend on the willingness of nations to cooperate, and that is not always politically possible. One can only hope that humankind is up to that challenge.

As we said at the beginning of the chapter, our discussion of international law was guided by our broader interest in understanding the legal environment of international business. For that reason, our approach and coverage has been somewhat different from that applied in traditional courses in international law.

Finally, there are several topics traditional to the study of international law that must wait for the next chapter on the resolution of international commercial disputes.

Chapter Summary

1. International law includes public and private international law. Public international law governs the conduct of nations with other nations or the conduct of nations in their relationships with individuals. Private international law governs the rights and responsibilities of private individuals or corporations operating in an international environment, such as international sales contracts or shipping. International law relies primarily on "soft" enforcement mechanisms: the force of public opinion, trade and diplomatic sanctions, and the withholding of foreign aid. The ultimate sanction is war.
2. Customary international law is derived primarily from the widespread and long-standing practices of nations. International law also arises from agreement. A treaty is a legally binding agreement between two or more nations that is recognized and given effect under international law. A convention is a multilateral treaty on a topic of broad international concern.
3. International business law is any law or regulation, whether derived from national or international sources, that governs cross-border business transactions, the activities of those doing business in



- foreign countries or subject to the jurisdiction of foreign courts, or the resolution of international business disputes.
4. Uniformity and predictability in international business law are important to companies that do international business.
 5. Transnational business crimes are major problems calling for global solutions. Typical crimes include bribery and corruption, tax evasion, customs fraud, criminal violations of export control laws, financial crimes, and criminal violations of environmental laws, securities laws, and antitrust laws.
 6. Jurisdiction means the power of a nation to create laws that proscribe conduct and to act over individuals, corporations, or their property in the application or enforcement of those laws. When used in reference to a court, it is the power of a court to act or to hear a case—to adjudicate. There are five doctrines of international criminal jurisdiction: territoriality, nationality, the protective principle, passive personality, and universality.
 7. Extraterritoriality refers to a nation's jurisdiction that extends beyond its territorial borders.
 8. The International Court of Justice hears cases brought by nations against other nations.

Individuals and private corporations are not parties to cases before the court. The court has jurisdiction over all cases brought by nations under the *UN Charter* or involving treaties, conventions, international obligations, or questions of international law. Jurisdiction is not compulsory; each nation must agree to submit to the court's jurisdiction.

9. Business ethics and social responsibility are important to the stakeholders of all companies. But these can be vague concepts for firms operating in different parts of the world. One solution, in addition to legal penalties, are voluntary codes of conduct produced by international organizations and corporations. While some people can argue their effectiveness, they do provide a common framework for management, and they do focus the spotlight of world public opinion on the problem and its solutions.
10. Comparative law refers to the study of differences in national laws and legal systems. These differences cover the entire range of law—marriage and family law, business law, torts, crimes, and more. There are also differences in legal procedures, the role of legislation and case law, the function of judges, the conduct of trials, the use of legal remedies, and punishments in criminal cases.

Key Terms

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Questions and Case Problems

1. Bellaizac-Hurtado and others were arrested in Panama for drug trafficking aboard a Panamanian-flagged vessel in Panamanian waters. They were extradited to the United States for prosecution under the *Maritime Drug Law Enforcement Act*. They argued that the law was unconstitutional as applied to them. The United States claimed that under Article I, Section 8 of the Constitution, Congress has the power to "Define and punish . . . offenses against the law of nations" and therefore the statute was properly applied. The defendants contended that the language "offenses against the law of nations" refers only to violations of "customary international law." No one would disagree that drug trafficking is "universally condemned." But is drug trafficking a violation of customary international law? Why or why not? How did the court rule? *United States v. Bellaizac-Hurtado*, 700 F.3d 1245 (11th Cir. 2012).
2. Kiobel and other environmental activists were arrested, tortured, and executed by the Nigerian military in 1995. They had been protesting Shell's oil exploration in the Ogoni region of Nigeria. A lawsuit was brought by Kobel's widow and others under the *Alien Tort Statute* (ATS) in the United States against three Royal Dutch Shell companies alleging that the companies had aided and abetted the Nigerian military in committing human rights abuses in violation of customary international law. The defendant corporations are incorporated or headquartered in the Netherlands, the United Kingdom, and Nigeria. None of the plaintiffs or defendants are citizens of, or incorporated in, the United States. May an individual may bring an action under the ATS against a corporation for violations of customary international law? If not, do you think that international law should permit damage suits against individuals but leave corporations free to violate the law without consequences? Should a corporation be able to shield its profits from human rights abuses by simply doing business as a corporate entity? *Kiobel v. Royal Dutch Petroleum Co.*, 133 S.Ct. 1659 (2013).
3. The defendants conspired to transport 191 Ecuadorian nationals into the United States illegally aboard a 54-foot fishing vessel. A U.S. Navy helicopter sighted the overcrowded vessel off the Guatemalan coast and saw that it had no lights and flew no flag. A Coast Guard detachment found the passengers with little food or water, and the defendants had left the vessel. The defendants were indicted in the United States for conspiracy to induce aliens to illegally enter the United States, and attempting to bring unauthorized aliens to the United States. (8 U.S.C. § 1324). The statute does not mention jurisdiction. The defendants argued that the statute did not apply extraterritorially. Does it? Why or why not? Do you think the "Bowman Exception" applies in this case as described in *U.S. v. Campbell*, earlier in the chapter? Why or why not? The terrorist attacks of September 11, 2001, were planned overseas. Where are immigration offenses planned? How is that relevant to your legal analysis? Explain. *U.S. v. Delgado-Garcia*, 374 F.3d 1337 (D.C.Cir. 2004).
4. Assume that someone in a foreign country poisons a shipment of pharmaceuticals destined for the United States, resulting in death of an American consumer in violation of 18 U.S.C.1365 (tampering with a consumer product). Under what circumstances could they be prosecuted in the United States? Would any principle of international law justify bringing them to trial in the United States? Could you argue that the decision in *U.S. v. Campbell* (see chapter) would apply to this situation?
5. What types of issues lend themselves to international solutions through international law?
6. You overhear someone say, "International law does not exist." What do they mean? What evidence can you provide to persuade them that they are mistaken?
7. Internationalists often refer to the "unification" or "harmonization" of international law. What do you think these terms mean? What factors have influenced the harmonization of international business law? In what ways do you think IBL is more "national" than international?
8. Do you think corporate codes of conduct can have an effect on making firms more socially responsible? Are they a substitute for government regulation or do they complement it? Explain.
9. What ideas do you have for setting up an accountability system to ensure compliance with codes of conduct and other ethical and social responsibility standards for business?
10. Why must corporations be concerned about human rights issues when doing business internationally? Who are the "stakeholders" of a public corporation, and what is management's responsibility to them?
11. What are the different forms of criminality that are of concern to international businesses? Explain why international solutions are important. Give some examples.
12. Describe the five theories of international criminal jurisdiction. How have these been made applicable to



international terrorism? What types of crimes are covered under the principle of universality? From an international law perspective, do you think that terrorism should be a universal crime? Why or why not?

13. Students often confuse the International Court of Justice with the International Criminal Court. What is the difference between them? Although not covered in this chapter, what is the European Court of Justice and what is its jurisdiction?

Managerial Implications

1. You are a vice president of a multinational corporation headquartered in North America. You are asked to visit Latin America to meet with government officials to consider a location for a new factory. On your arrival, you are met at the airport by one of your hosts, who spends some time that day taking you on a tour of the city and getting acquainted. That evening you are invited to his home for dinner with government representatives. After dinner, one of the guests who works for a key government ministry asks what you think of your company's role in his country as an employer, taxpayer, and corporate good citizen. He makes it clear that his country is no longer a "puppet" of the North Americans. He asks you to show him that you understand his concerns and to show him that your company will be respectful of his country's culture, environment, natural resources, and local laws. How do you respond?
2. Assume that a Korean company manufacturing critical tail assemblies for commercial aircraft ships several defective assemblies to manufacturers in the United States. The CEO, a Korean national, was not only aware of the defects at the time the assemblies were being made but was also

responsible for knowingly using inferior parts. He even threatened an engineer with termination if he leaked the truth. One of the assemblies failed on the American-made plane, leading to the crash of a Canadian-flag passenger airline on takeoff from New York. When the investigation leads to him, he flees Korea for Saudi Arabia, where he lives for several years in luxury. Which countries have jurisdiction to prosecute the Korean citizen, and under what legal principles? You do not need to research any international treaties, but you should base your analysis on general principles from this chapter.

3. Your company owns and operates a factory in a foreign country when it is invaded by a neighboring army over a border dispute. The invading government claims that your factory is actually on land belonging to them. Their soldiers destroy your buildings, threaten your employees, and arrest your local manager. While a complete answer to resolving this question will have to wait until later in the book, what recourse do you think you might have under international law against the invading country, if any? How might you proceed? Do you think it would be of any help to contact the U.S. State Department? Why?

Ethical Considerations

We have considered many subjects in this chapter that raise ethical issues—human rights law, international criminal law, international labor standards, bribery and corruption, and others. Here are two cases to consider as food for thought.

Exports of "Unsafe" Pharmaceuticals

Some years ago, it was reported in the world's press that American pharmaceutical companies were selling in developing countries expired medicines that were no longer permitted to be sold in the United States. Assess the validity of the following arguments:

There are two sides to every debate. We are talking about antibiotics that are lifesaving and in short supply in some developing countries. True, they are expired under federal regulations in the United States, but they will still be

effective for some time to come. It is not illegal overseas, and maybe not illegal to export them, so why should I do anything more than just obey the law? After all, we are selling them at reduced prices to the governments of developing countries. They probably have foreign aid money to buy these with. They will sell them, or give them away, to poor people that otherwise would not be able to afford any medicine at all. Why should I destroy them? After all, we are not talking about AIDS, are we? I wonder what the world and big pharmaceutical companies are doing about that problem?

Bribery as a "Cost of Doing Business"

What are the economic, political, and social arguments for and against criminalizing the bribery of foreign government officials in developing countries by employees and



representatives of Western companies? Assess the validity of each of the following arguments in this statement:

I've always thought that bribery is endemic in the developing countries, so 'When in Rome, do as the Romans do.' It's legal there, isn't it? Nothing would happen to me if I get caught there, would it? My government does not have the right to say whether what I do in a foreign country is a crime. They can't tell me what is legal or illegal over there. And I don't have a moral problem, either. I see it as a small price to pay—my company just considers this another 'cost of doing business.' We might even try to deduct it on our corporate income tax returns. If I don't offer cash payments or gifts to my customers in

government offices overseas, then my competitors from other countries will. Foreign customers will just buy from my competitors. If I don't pay, I'd just be giving my competitors a 'corruption advantage.' And what difference does this make anyway? Why should my country care? I've heard about companies that gave cash payments to the Shah of Iran when he was in power in the 1970s, to his government ministers, even to members of his family. They got contracts worth tens and hundreds of millions of dollars to install everything—telecommunications systems, power plants, and refineries, and, most of all, armaments and weapons. I heard he was a brutal dictator, but so what? That's not my problem. I don't see what the problem is.